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Commodity Futures Markets Leading to Food Inflation in India?

- Piyush Pant

Modi government, which came to power piggybacked on UPA government's failure to control the rising prices of ood items, too has failed to rein in the food inflation. So much so that India's annual consumer price inflation edged up to 5.0 percent in October, up for the third straight month, compared with 4.41 percent a month ago as shown by the government data. Unable to control the inflation, the NDA government has been taking shelter behind excuses like failure of monsoon and the spurt in consumer demand due to festive season but shying away from admitting that the real culprit is the 'Commodity Futures Market'. In fact the hand of commodity futures market in creating artificial spurt in the prices of food items was visible since 2004 when the major steps towards introduction of futures trading in commodities were initiated with the removal of prohibition on futures trading in all recommended commodities and setting up of commodity exchanges at the national level. Since then, the commodity futures markets have witnessed a rapid increase in trading volumes, market participation and the number of commodities traded.

Developing countries like India, China, Brazil and South Africa have important commodity derivatives markets. It is said that the monthly turnover in Indian commodity exchanges is next only to the US and China. However, despite rapid growth in trading volume, the Indian commodity futures markets have frequently courted controversy in India due to numerous factors, including pervasive market abuses and manipulation that have badly affected market integrity, weakened integration of spot and futures markets, raised concerns over price rise, and poor regulation and supervision.

This is not the case for India alone but has been true globally. Neeraj Mahajan and Kavaljit Singh , in a book titled 'A Beginner's Guide to Indian Commodity Futures Markets' say that when food prices rose dramatically worldwide during the 2007-2008 period, food riots broke out in many poor countries and there were fears of high price volatility and inflation in the developed countries. The food price spike created a global food crisis. Concerns over the social unrest and economic instability compelled the policymakers to examine the factors behind the worldwide increases in food prices. Apart from analyzing developments in the spot markets, the policymakers also turned their attention to the commodity derivatives markets, which had been undergoing major changes since 2000. The writers say that in India, too, the role of futures trading in aggravating the price hike was hotly debated when the government banned futures trading in several agricultural commodities in 2008 to control food inflation.

Another development worth taking note of is that the public services in the European Union (EU) are coming under threat from international trade negotiations that endanger governments' ability to regulate and citizens' right to access basic services like water, health, and energy, for the sake of corporate profits. The EU's CETA (Comprehensive Economic and Trade Agreement) with Canada' whose ratification could begin in 2016 and TTIP (Transatlantic Trade and Investment Partnership) treaty under negotiation with United States are the latest culmination in such efforts. In a worst case scenario, they could lock in public services into a commercialization from which they will not recover - no matter how damaging the results may be. German writer Thomas Fritz points towards the secretive collusion between big business and trade negotiators in the making of the EU's international trade deals. It shows the aggressive agenda of services corporations with regard to TTIP and CETA, pushing for far-reaching market opening in areas such as health, cultural and postal services, and water, which would allow them to enter and dominate the markets. And it shows how those in charge of EU trade negotiations are rolling out the red carpet for the services industry, with both the consolidated CETA agreement published in September 2014, as well as drafts of TTIP chapters and internal negotiation documents that reflect the wish-lists of corporate lobbyists.

In this issue of **INFOPACK**, the documents discussing these issues have been summarized.

A Beginner's Guide to Indian Commodity Futures Markets

By:

Neeraj Mahajan and Kavaljit Singh

Published by:

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Bird's Eye View

Besides **Introduction** this 91-page document is divided into three parts.

Part I explains the basics of commodity futures in a historical and theoretical context. It provides a basic understanding of concepts and terminology related to commodities, derivatives, commodity futures trading, commodity exchanges and market participants. The financialization of commodities and its implications are critically examined in this section besides discussion of some of the important scandals in the global commodity markets.

Part II specifically deals with issues and concerns related to the Indian commodity futures markets. It examines the policy environment that has shaped the rise of Indian commodity futures markets in the recent times. In particular, instances of frequent manipulation and some recent trading scandals in the Indian commodity futures markets are discussed at length. This section also explores the efficacy of commodity transaction tax and provides policy recommendations to strengthen the regulation and supervision of Indian commodity futures markets.

Part II consists of six chapters.

Part III focuses on key policy issues and challenges faced by commodity futures markets. By citing examples from the Indian markets, it questions the role of excessive speculation, algorithmic trading and other practices that tend to undermine the usefulness and efficiency of a commodity futures market. Some of the recent policy initiatives and regulatory reforms are also discussed in this section.

Part III contains only one chapter.

In the **Introduction**, the writers say that when food prices rose dramatically worldwide during the 2007-2008 period, food riots broke out in many poor countries and there were fears of high price volatility and inflation in the developed countries. The food price spike created a global food crisis. Concerns over the social unrest and economic instability compelled the policymakers to examine the factors behind the worldwide increases in food prices. Apart from analyzing developments in the spot markets, the policymakers also turned their attention to the commodity derivatives markets, which had been undergoing major changes since 2000. In India, too, the role of futures trading in aggravating the price hike was hotly debated when the government banned futures trading in several agricultural commodities in 2008 to control food inflation. Over the centuries, commodity trading has undergone tremendous changes, from the barter system to spot markets to futures markets.

The writers further say that even though organized commodity derivatives in India began in the 19th century, commodity future markets have flourished in recent years with the onset of reforms to liberalize the economy in the 1990s. The major steps towards introduction of futures trading in commodities were initiated in 2004 with the removal of prohibition on futures trading in all recommended commodities and setting up of commodity exchanges at the national level. Since then, the commodity futures markets have witnessed a rapid increase in trading volumes, market participation and the number of commodities traded. The commodity futures were initially permitted to trade in agricultural products but nowadays bullion, metals and energy products dominate the trading volume.

India and other developing countries such as China, Brazil and South Africa have important commodity derivatives markets. The monthly turnover in Indian commodity exchanges is next only to the US and China. However, despite rapid growth in trading volume, the commodity futures markets have frequently courted controversy in India due to numerous factors, including pervasive market abuses and manipulation that have badly affected market integrity, weakened integration of spot and futures markets, raised concerns over price rise, and poor regulation and supervision.

The writers say that it is the duty of regulatory authorities to curb rampant manipulation and other unfair trading practices. In the aftermath of the 2008 global financial crisis, some regulatory reforms have been initiated in the US, European Union (EU) and some other countries to enhance market transparency and coordination among regulatory authorities. But a lot still needs to be done to ensure appropriate market surveillance and enforcement at both national and international level.

The writers say that this Guide is prepared with an aim to engage citizens, farmers, parliamentarians, market practitioners, policy makers, academicians and students with interest in the area of commodity derivatives markets in general and Indian markets in particular. The Guide explains basic concepts and workings of the commodity derivatives markets, raises several policy concerns and provides specific policy recommendations to improve the regulation and supervision of markets in the public interest.

Part-I consists of six chapters.

Chapter I: Understanding Commodities

In this chapter, the document, while explaining about commodities, says that commodities are products that can be bought, sold or traded in different kinds of markets. Commodities are the raw materials that are used to create products which are consumed in everyday life around the world, from food products in India to building new homes in Europe or to running cars in the US.

There are two types of commodities:

- Soft commodities - agricultural products such as corn, wheat, coffee, cocoa, sugar and soybeans; and livestock.
- Hard commodities - natural resources that need to be mined or processed such as crude oil, gold, silver and rubber.

In the global markets, there are four categories of commodities in which trading takes place:

- Energy (e.g., crude oil, heating oil, natural gas and gasoline).
- Metals (e.g., precious metals such as gold, silver, platinum and palladium; base metals such as aluminium, copper, lead, nickel, tin and zinc; and industrial metals such as steel).
- Livestock and meat (e.g., lean hogs, pork bellies, live cattle and feeder cattle).
  Agricultural (e.g, corn, soybeans, wheat, rice, cocoa, coffee, cotton and sugar).

The document says that commodities play an important role in the economic development of all countries - developed, developing and least developed countries (LDCs).

According to UNCTAD (United Nations Conference on Trade and Development) statistics, 27 LDCs are commodity exporters. In fact, commodities accounted for almost 80 percent of LDCs' goods export during 2007-2009. Given the LDC's heavy dependence on commodities, any development strategy aimed at economic growth, poverty reduction and food security needs to recognize the crucial role played by commodities and natural resources in these economies. As witnessed during the recent triple crises - food, financial and fuel - the economies of LDCs remain vulnerable due to their over-reliance on few primary commodities, and price volatility.

The document further says that there are two types of commodity markets: spot (physical) and derivatives (such as futures, options and swaps).

In a spot market, a physical commodity is sold or bought at a price negotiated between the buyer and the seller. The spot market involves buying and selling of commodities in cash with immediate delivery. Spot markets also include traditional markets such as Delhi's Azadpur Mandi that deal in fruits and vegetables.

On the other hand, a commodity can be sold or bought via derivatives contract as well. A futures contract is a pre-determined and standardized contract to buy or sell commodities for a particular price and for a certain date in the future. For instance, if one wants to buy 10 tonne of rice today, one can buy it in the spot market. But if one wants to buy or sell 10 tonne of rice at a future date, (say, after two months), one can buy or sell rice futures contracts at a commodity futures exchange.

The futures contracts provide for the delivery or receipt of a physical commodity of a specified amount at some future date. Under the physically settled contract, the full purchase price is paid by the buyer and the actual commodity is delivered by the seller. But in a futures contract, actual delivery takes place later. For instance, a farmer enters into a futures contract to sell 10 tonne of rice at $100 per tonne to a miller on a future date. On that day, the miller will pay the full purchase price ($1000) to the farmer and in exchange will receive the 10 tonne of rice.

However, under the cash-settled futures contract, the farmer and the miller would simply exchange the difference between the spot price of rice on the settlement date and the agreed upon price as mentioned in the future contract and there would be no actual delivery of rice. Following the above example, if on the settlement date the price of rice was $80 tonne, while the agreed upon price of futures contract was $100 a tonne, the miller will pay $200 to the farmer in cash and there will be no delivery of rice to the miller. If, on the settlement date, the price of rice was $120 a tonne, the farmer will pay $200 to the miller in cash and delivery of rice will take place.

In practice, most futures contracts do not involve delivery of physical commodity as contracts are settled in cash through an exchange. The financial investors prefer cash settlement because of no interest in buying or selling the underlying commodity, and lower transaction costs. Nowadays, the entire process of futures trading in commodities is carried out electronically throughout the world.

The document also points out that the sharp upward and downward movement in prices (in other words, price volatility) is one of the key problems associated with commodities. Price volatility can result from irregular production and harvests as well as from swings in demand and supply. Volatility evokes risks for both producers and consumers. Volatile prices can have a devastating impact on economies. For instance, if higher prices for imported oil continue for a prolonged period of time, it can generate serious payments problems, as was witnessed in India during the 1990-1991period. On the other hand, lower prices can lead to less income for commodity exporting countries.

A combination of domestic and international factors drives prices in global commodity markets. There is no denying that the rapid growth in production and consumption of China and India has contributed to a massive surge in demand for commodities from energy to minerals in recent years. In addition, intense speculative activity by financial players, geo-political factors and tight supply capacities have also significantly affected commodity prices and volatility.

Chapter II: Understanding Derivatives and Commodities Futures Trading

Under this chapter, the document says that a derivative contract is an enforceable agreement between two parties where the value of the contract is based or derived from the value of an underlying asset. The underlying asset can be a commodity, stock, precious metal, currency, bond, interest rate, index, etc.

Some of the widely used derivative contracts are as following:

Forwards: A forward contract is a non-standardized or customized contract between two parties to undertake an exchange of the underlying asset at a specific future date at a pre-determined price. It is transacted over-the-counter and is not traded on an exchange. The contract is executed by both parties on the due date by delivery of asset by the seller and payment by the buyer.

Futures: Commodity futures contracts are agreements made on a futures exchange to buy or sell a commodity at a pre-determined price in the future. The futures contracts are traded on regulated exchanges and the terms of the contract are standardized by the exchange. What is negotiated by the counter parties (buyer and seller of a futures contract) is only the price. The price is discovered through the offers and bids process. All contracts are settled by cash or physical delivery of the underlying commodity on the expiry date of the contract. In Indian exchanges, almost all commodity futures contracts are cash-settled.

Options: Commodity options are contracts that give the owner the right, but not the obligation, to buy or sell an agreed amount of a commodity on or before a specified future date.

Swaps: A commodity swap is an agreement between two parties to exchange cash (flows) on or before a specified future date based on the underlying value of commodity, currency, stock or other assets. Unlike futures, swaps are not exchange-traded instruments. Swaps are usually designed by banks and financial institutions that also arrange the trading of these bilateral contracts.

The document also points out that there are two groups of derivative contracts - exchange-traded and over-the-counter (OTC) - based on the manner in which they are traded in the market.

Exchange-traded derivatives are those instruments (such as futures and options) that are traded on derivatives exchanges. The last decade has witnessed tremendous growth in this segment.

The commodity derivatives markets are only a small part of global derivatives trading that is based on underlying assets such as currencies, interest rates, stocks and other financial instruments.

OTC derivatives are contracts that are privately negotiated and traded between two parties, without going through an exchange. The market players trade with one another through telephone, email, and proprietary electronic trading systems. The most common products traded in OTC derivative market are swaps, exotic options and forward rate agreements.

The OTC derivative market is mainly dominated by banks, hedge funds and other highly sophisticated financial players. However, OTC commodity derivatives are used for non-standardized contracts that can meet specific demands of the contracting parties. The OTC derivative market is the largest market in the world of which the commodity OTC derivatives are the smallest part and the interest rate and foreign exchange derivatives contracts are the most significant.

Since OTC derivatives contracts are privately negotiated and traded without any supervision of an exchange, there is always the risk of a counterparty defaulting. The counterparty risk has gained particular importance following the collapse of major financial institutions such as Lehman Brothers in 2008 and has been addressed in the post-crisis regulatory reform programmes. The OTC markets, which began in the 1980s, are still opaque and subject to fewer regulations. The G20 reforms also require OTC derivatives to be reported for greater transparency.

Derivatives indeed are a double-edged sword - these instruments can help in risk management but can also increase risks and erode returns. It is very important to differentiate between hedging and speculative purposes of using derivatives. The hedgers use derivatives to reduce or eliminate risk while speculators use derivatives to profit from exposure to risk.

The document further says that if used for hedging purposes, derivatives can act a valuable risk management tool to protect the value of the underlying asset (commonly, stock and currency) from adverse market price movements in the future. By reducing parties' risks while hedging and facilitating price discovery, derivatives can perform a social function even though most hedging is risky and speculative. If derivatives are used purely for taking large speculative positions, it may lead to traders incurring huge losses since derivatives are leveraged instruments where one commits to buy or sell a large quantity of commodities or stocks by only paying upfront a part of the total cost.

The financial leverage allows traders to trade in futures contracts of a higher market value with a small amount of capital. For example, one futures contract for gold is usually of 100 troy ounces. If the trading price of gold is $400 per ounce, then the value of the contract would be $40,000.

Many traders and firms often fail to comprehend the true risks associates with derivatives trading and end up suffering phenomenal losses while trying to profit from predicting future events. A slight mishandling of trading can lead to huge losses.

Due to rapid changes in the global banking system, the OTC derivative markets have become more concentrated in the hands of a few banks. Increased concentration in OTC derivative markets highlights the potential adverse impact on the entire financial system.

The large scale trading of derivatives contracts for purely speculative purposes adds risk to the entire system. Large exposures to one another and greater interconnectedness among these key market participants increases the repercussion effects of stocks if one of the key market payers were to default on its obligation. The ability of market participants to assess the risks faced by the counterparties is hampered by the fact that many derivatives are off-balance sheet items. Such lack of disclosures leads to counterparties having no idea about the financial health of the firm with which they are dealing in the OTC markets.

The recent experience clearly shows that the regulatory authorities have lagged in foreseeing the risks involved in the derivatives trading, particularly in the OTC derivatives markets, largely because of the steady deregulation of derivatives trading since the 1990s. It was the deregulation of financial derivatives under the Commodity Futures Modernization Act (CFMA) of 2000 that eventually brought the US banking system to its knees. Post-crisis, the real challenge before regulatory bodies is to curb speculative behaviour and bring discipline in derivatives markets so that financial disasters of such magnitude do not recur.

While talking about the key functions of commodity futures trading, the document says that the two major economic functions of a commodity futures trading are **price risk management** and **price discovery**. A future exchange carries out these twin functions by providing a trading platform that brings buyers and sellers together.

The price risk management (also called hedging) is considered to be the most important function of a commodity futures market. The hedging is used to manage price risks. It allows transfer of price risk to other agents who are willing to bear such risks. The hedgers, in principle, buy futures contracts for protection against rising commodity prices and sell futures for protection against falling prices or to get a guaranteed price in the future. Hedgers use futures market to protect themselves against price adverse changes and are often interested in taking or making physical delivery of the underlying commodity at a specified price. On the other hand, speculators, gamblers and other non-commercial players trade futures contracts strictly to make profits by betting on price movements. Such players have no interest in taking possession of the underlying commodity.

Initially, commodity futures markets were created for the benefits of hedgers (i.e., producers or users of the underlying commodity) who would like to get guaranteed prices for their product. The commodity futures market can be potentially beneficial to producers and users of commodities (including farmers, manufacturers, bulk users, traders, exporters and importers) who can pass the price risk on an expected purchase or sale of physical commodity to other agents (speculators) who participate in these markets without any physical backing.

The premise of hedging is the key reason behind the existence of commodity futures exchanges. It has greater significance in a country like India where over 60 percent of the population is dependent on agriculture and farmers face various kinds of uncertainties and risks including price risk. In India, the original purpose behind re-introduction of futures trading was to help farmers hedge against potential risks arising out of price movements in agricultural commodities.

The farmers can participate in futures market to manage price risk arising from decline and rise in commodity spot prices in the future. For instance, a guar farmer faces the possibility of incurring a loss on account of decline in guar speed prices at harvest time. At the time of sowing, the guar farmer can reduce or eliminate his risk by entering into a futures contract to sell guar seed at Bikaner exchange (Rajasthan) at a certain fixed price. By doing this, the farmer has hedged his exposure to changes in guar prices; he is no longer affected by adverse price changes in prices of guar, because he is guaranteed to get the price quoted in the futures contract. This strategy is known as a short hedge. **In India, however, such type of direct participation by farmers is seldom seen because farmers have little knowledge of futures markets. Besides, trading in future markets is cumbersome as it involves meeting various membership criteria, bank transaction norms, daily payments of margins, etc. In the US, however, big farmers and agribusiness corporations do take part in the futures markets.**

On the other hand, a guar gum manufacturer plans to buy guar seeds in the future may suffer a loss on account of an increase in guar seed prices. To minimize or eliminate the risk, the manufacturer may enter into a futures contract to buy the guar seed at a certain fixed price. The strategy is known as a long hedge.

It is important to note that the commodity futures price, the price agreed upon by the parties for the future transaction, is a market estimate about the future price of the underlying commodity. It may be higher or lower than the spot price of the commodity in the spot market. Thus, the futures price could be used as an estimate of the spot price of a commodity at some future date. However, futures prices keep changing until the last date of the futures contract subject to additional information about demand and supply.

The document further says that some of the necessary pre-conditions required for futures trading in a commodity include:

- There should be large demand for and supply of the physical commodity and no individual or group of persons acting in concert should be in a position to influence the demand or supply, and consequently the price substantially;
- There should be fluctuations in prices of that commodity. If the prices of a particular commodity are relatively stable, there is very less price risk involved in the commodity, and therefore, trading in that commodity is less meaningful;
- The market for the physical commodity should be free from substantial government contract;
- The commodity should have long shelf life;
- The commodity should be capable of standardization and gradation.
- The regulatory authorities should have powers and willingness to enforce new regulations and laws and

exercise appropriate oversight of trading on the futures exchange with powers to curb market abusive practices.

- The delivery points where farmers need to physically deliver the underlying commodity should not be too far away from the harvest place.

In India, the market regulator- Forward Market Commission - decides the suitability of a commodity to be traded on the exchange.

While talking about the difference between **'underlying'** and **'contract'**, the document says that a commodity (such as silver, rubber or wheat) available for future trading is called an "underlying", i.e., the commodity based on which the derivatives' value is derived from. There can be different future contracts for the same underlying depending on location and expiry date.

The document also says that the price signal can provide a direction to a farmer about what a commodity will be worth at a future point of time and, on the basis of future prices, he can take decisions on what to produce on the likely prices in the near future.

It further says that theoretically speaking, the difference between spot and futures contract should decline over the life of a contract so that spot and futures prices are the same on the date of maturity of the contract. This is known as 'convergence' of spot and futures prices, though the futures market and spot market operate as separate entities.

In reality, price discrepancies between these two markets may exist due to excessive speculation and price manipulation in the futures markets. The threat that a commodity will not be delivered as foreseen in the contract is an important factor for preventing price convergence between the spot and futures markets.

The regulatory authorities and futures exchanges can facilitate proper price convergence by ensuring that there is a credible threat of delivery of commodities. It discourages the market participants from manipulating futures prices. Other measures to curb excessive speculation include imposition of position limits and higher margins.

Chapter III: Understanding Commodity Derivatives Exchanges

In this chapter, the document says that a commodity exchange (also called bourse) is an organized physical or virtual marketplace where various tradable securities, commodities and derivatives are sold and bought.

During the 12th century, merchants began making commitments to buy or sell goods even before they were physically available to reduce the risk of looting while travelling along dangerous routes. The central function of these contracts, later called derivatives, was to guarantee a future price and avoid the risks of unexpected higher or lower prices. The late 19th century witnessed a spurt in commodity futures trading with the creation of exchanges. The main rationale was reduction of transaction costs as well as organizing a marketplace where buyers and sellers could find a ready market.

After the liberalization of agricultural trade in the 20th century, many countries withdrew support to agricultural producers and prices became more volatile. Consequently, commodity exchanges stepped in to fulfill the price discovery and hedging function and facilitate physical trading. Initially, these exchanges were located mainly in developed countries but soon the developing countries too caught on.

The key functions of the commodity derivatives exchanges include:

- Providing and enforcing rules and regulations for uniform and fair trading practices.
- Facilitating trading in a transparent manner.
- Recording trading transactions, including circulating price movements and market news, to the participating members.
- Ensuring execution of contracts.
- Providing a system of protection against default of payment (clearing).
- Providing a dispute settlement mechanism.
- Designing the standardized contract for trading which cannot be modified by either parties.

Ideally, a commodity derivatives exchange needs to provide a seamless trading platform with a fair, transparent and financially secure trading environment in keeping with the robust risk management practices.

The exchange should also maintain a Settlement Guarantee Fund (SGF) to ensure a high level of protection against the risk of default by a trader. Importantly, the clearing house (the CCP), or the SGF of the exchange has to be used in case of default by a buyer or seller to pay the other party. In order to guarantee that the parties will execute the contract and to maintain reserves to deal with default, the clearing houses or SGF request the parties to provide collateral (called margin) in the form of cash or securities.

The document further says that the exchange designs the standardized contract for trading which cannot be modified by the either party. The exchange guarantees a financially secure environment for risk management and guaranteed performance of contract.

In theory, the future prices are determined by the forces of demand and supply for a particular commodity in any market. The price rises if purchase volumes outnumber sales volumes, and vice versa. The bargaining (bids and offers) for commodity derivatives contracts converge at the trading floor on the specified maturity date in the future. The way exchange trading is conducted is also influenced by the domestic regulatory regime. In practice, future prices can also be influenced by buying and selling by speculators when they engage in excessive speculative trading that is unrelated to the physical market.

Chapter IV: The Market Participants

Under this chapter, the document points out who are the main players in a commodity market. According to it, the main participants are:

Scalpers/Day Traders: They are those participants who take positions in futures contracts for a single day and liquidate them prior to the close of the same trading day. The scalpers have the shortest time horizon. They hold their position for a few minutes while day traders close their positions before the end of trading each day. Both the scalpers and the day traders attempt to make profit out of the intra-day movement in commodity futures prices. These market players provide liquidity in futures market due to large volumes of transactions undertaken by them. However, it needs to be acknowledged that such players can also negatively affect the price formation and market functioning due to excessive reliance on speculative trading.

Hedgers: Hedgers are essentially players with an exposure to the underlying commodity and associated price risk - producers or consumers who wish to transfer the price risk on to the market. The futures markets exist primarily for hedgers. The hedgers simultaneously operate in the spot market and the futures market. They try to reduce or eliminate their risk by taking an opposite position in the futures market on what they are trying to hedge in the spot market so that both positions cancel one another. They operate in the spot market to buy or sell the physical commodity, and in the futures market to offset any loss arising out of price fluctuations in the spot market.

Speculators: They are traders with no genuine commercial business to the underlying; they do not hedge but trade with the objective of making profits from movements in prices. The speculators generally assume higher risk and also expect a higher return on their investments. They do not have any real need to buy, sell or take delivery of the actual commodities. They wish to liquidate their positions before the expiry date of the contract and carry out a purely financial transaction. Due to the margin system, speculators operate in the futures market with minimum investments. In the financial media, speculators are frequently labeled as investors and non-commercial players.

Arbitrageurs are traders who trade and sell to make money on price differentials across different markets.

They simultaneously buy and sell the same commodities in different markets. Arbitrage keeps the prices in different markets in line with each other. Usually, such transactions are risk-free.

Aggregators bring liquidity in the futures market and help farmers to benefit from price discovery and price discovery and price risk management. Aggregators could be farmers' cooperative, agricultural institutions like NAFED (National Agricultural Cooperative Marketing Federation), farmers' or producers' union and non-governmental organizations that are allowed to collect commodities from farmers and sell in the futures market.

Position Traders maintain overnight positions, which may run into weeks or even months, in the anticipation of favourite movement in the commodity futures prices. They may hold positions in which they run huge risks and may also earn big profits.

Brokers typically act as intermediaries and facilitate hedgers and speculators. A commodity broker is a firm or individual who acts as a go between to buy or sell commodity contracts on behalf of clients - for a commission.

The Exchange is a central place (physical or virtual) where market participants trade standardized futures contracts.

Regulator oversees the working of the exchange. The Forward Markets Commission (FMC) is the regulatory authority for the commodity futures market in India. It is equivalent of the Securities and Exchange Board of India (SEBI), which regulates the equities markets in India.

The documents further says that there are several reasons behind the low participation of farmers and their representative institutions in the Indian futures markets, some of which are listed below:

- Farmers cannot afford to pay the fees for maintaining trading account with the brokers besides warehouses and assaying costs;
- Farmers find the trading requirements such as payment of margins to be burdensome;
- The minimum lot size of the futures market is much larger than the marketed surplus for most of the farmers in India. As a result, marginal and small farmers who need risk coverage the most are totally excluded;
- Most Indian farmers are incapable of participating in the futures markets because they lack the skills needed for trading on electronic exchanges.

The document also points out that **foreign investors** are not allowed to trade in the Indian commodity markets. Currently only resident Indians, companies and traders are allowed to trade in Indian commodity markets.

Similarly, banks and financial institutions are not allowed to trade in commodity futures markets in Indian. As per the existing regulatory framework, banks in India are allowed to trade in financial instruments (shares, bonds and currencies) in the securities market. But the Banking Regulation Act, 1949, prohibits banks (domestic and foreign) from trading in goods.

However, banks are allowed to finance commodity business and provide lending payment settlement facilities to commodity traders to meet their working capital requirements. Banks also provide clearing and settlement services for commodities derivatives transactions. But banks cannot trade in commodities themselves. In addition to banks, mutual funds, provident funds, insurance companies and foreign institutional investors (FIIs) are not allowed to trade in Indian commodity futures markets.

On December 10, 2012, the Indian finance minister P. Chidambaram, proposed to add a new clause in the Banking Laws (Amendment) Bill, which allowed the entry of banks in commodity futures trading India. After strong opposition by political parties on the grounds of parliamentary impropriety, the government dropped it from the Bill on December 18, 2012. However, it is expected that this clause would be incorporated in the forthcoming Forward Contract Regulation Act (Amendment) Bill, expected in 2015.

Chapter V: The Financialization of Commodities

The document, under this chapter, says that a rapid deregulation of commodity and financial markets coupled with swift technological advancement (e,g., computerized trading based on algorithms) and financial innovation (e.g., commodity index funds) have facilitated the entry of big financial players into both physical commodity markets and commodity derivatives markets (such as futures, options and swaps) in the major exchanges of the world (but not in India, where banks are prohibited from trading). The growing integration of financial and physical commodity markets over the last decade is popularly referred to as "financialization of commodities".

The key financial players (non-commercial participants) in the commodity futures markets are very diverse and include investment banks, merchant banks, swap dealers, insurance companies, hedge funds, mutual funds, private equity funds, pension funds and other large institutional investors.

Top 12 most active banks in commodity derivatives trading in 2011 were: Morgan Stanley, Goldman Sachs, JP Morgan, Barclays, Bank of America, Credit Suisse, Societe Generate, Deutsche Bank, Citigroup, BNP Paribas, Credit Agricole, HSBC.

The document further says that financial players view commodities as a separate asset class or as a part of real assets allocation. The traditional asset classes include equities, bonds and other fixed income securities, property and cash.

Financial players add commodity derivatives to their investment portfolio, i.e., the pool of money they invest, as part of a strategy to diversify their portfolio. They add commodities as "other asset class". Investment in commodities is seen as a balancing effect on the portfolio and acts as a price risk management tool to avoid prices of all the assets in a portfolio from going down or to hedge against inflation. In India, for instance, gold is often considered as a hedge against inflation.

It has been observed in many countries that investors show particular interest in commodities when the economy is in an expansionary phase. However, financial players can leave commodity markets if there are fewer opportunities to profit from speculative trading.

The arrival of purely financial players has dramatically changed the landscape of the global commodity futures markets. In recent years, the non-commercial futures positions have become by far the biggest component of futures markets.

It is important to note that trading by different kinds of players (hedgers, speculators and others) can affect the price formation and the interaction among them can determine market prices in a futures market. If in a particular futures market, there are more buyers (say, speculators) than sellers (say, hedgers), then an excessive speculative buying of futures contracts is likely to increase the price of contracts. With the result, prices will no longer be determined only by the interplay between supply and demand as related to the physical commodity markets.

The document also says that in 2006, the US Senate Permanent Subcommittee on Investigations issued a report showing how the injection of billions of dollars from speculation into the commodity futures markets had contributed to rising energy prices.

A 2013 study based on a database of Commodity-Linked Notes (a financial product linked to commodity derivatives prices) in the US found that the speculative investor flows cause significant price changes in the underlying futures markets and, therefore, provide direct evidence of the impact of "financial" investment on commodity futures price.

The dramatic rise and fall in prices of oil and agricultural commodities during 2006-2008 generated a heated debate in global policy circles whether speculation by financial players induced excessive price volatility. This issue was discussed at length at the G20 and several policy measures were recommended to improve the regulation and supervision of commodity derivatives markets. Two of the most important changes introduced in relation to OTC derivatives markets are the mandatory clearing of standardized OTC derivatives by central counterparties (CCPs) and the requirements for bilateral margin posting in non-standard OTC contracts.

In 2011, G20 agriculture ministers agreed to share reliable data on agricultural markets in order to ensure transparency in agricultural financial markets (including the OTC derivatives). They also called for greater collaboration between physical and financial regulators to improve the functioning of markets.

Chapter VI: A World Full of Manipulated Markets

The document says that a series of scandals in the past three decades have undermined the trust and integrity of global commodity markets. There have been several major scandals in the commodity markets centred around price manipulation in both futures and spot markets. This undermines a key function of the commodity futures exchanges, namely to provide a good forecast of future spot prices that can be used by players in the physical commodity trading and others. The deliberate price manipulation can result in losses for those players who use futures trading for hedging purposes.

Some of the major recent scandals have been due to poor regulation and supervision by the public authorities and the so-called "self-regulation" by the exchanges, which failed to timely detect manipulated trading practices. Some scandals were carried out simultaneously in both physical and derivatives markets in order to manipulate the price of commodities.

All these scandals underscore the need for proper regulation and supervision by competent and well-resourced authorities, both on the derivatives as well as the physical commodity markets. Some of the important scandals in the commodity markets are:

1. Silver Thursday and the Hunt Brothers Scandal
2. Crude Oil Price Fixing Scandal
3. The Enron Scandal
4. The Copper King Scandal

In **Part II**, there are seven chapters, including chapter VII to chapter XII.

Chapter VII: Commodity Futures Markets in India

In this chapter, the document says that India has a long history of derivatives trading in commodities. Commodity futures trading dates back to the ancient times. Researchers have found the mention of forward trading in commodities in Kautilya's Arthashastra. In 1857, the first organized futures market for cotton contracts was established by the Bombay Cotton Trade Association. In independent India, the Forward Contracts (Regulation) Act was enacted in 1952 to regulate the commodity trading in forward and futures contracts.

Despite such a long history, commodity futures trading (particularly in agricultural goods) has always remained controversial in India where more than 65 percent of the population is dependent on agriculture for livelihood. In the late 1960s, severe droughts forced many farmers to default on forward contracts. This, coupled with abusive market practices by some traders, led to increase in commodity prices, and the Indian government suspended forward trading in several commodities such as jute, edible oil seeds and cotton. For almost three decades, the futures trading was at a standstill, till India began liberalizing its economy in 1991.

In the post-liberalization period, largely on the advice of a study done by the World Bank and the United Nation Conference on Trade and Development (UNCTAD), and the recommendations of Kabra Committee Report, the Indian government lifted the ban on commodity futures trading in 2003. However, it is important to note that the Kabra Committee's recommendation not to allow futures trading in wheat, pulses, non-basmati rice, sugar, coffee, tea and other food products was not accepted by the government. The National Agricultural Policy (2000) also recommended the removal of price control and use of futures trading in agricultural commodities.

Despite the strong recommendation of the Guru Committee, that "all the commodities are not suited for futures trading", the central government went ahead to open up forward trading in 54 prohibited commodities like wheat, rice, sugar and pulses. Hence, it is clear from these developments that the government succumbed to the pressures of powerful lobbies and opened up important new avenues of profit making to speculators and traders.

While talking about the relations behind setting up commodity futures exchanges in India, the document says that one of the key reasons for the reintroduction of commodity futures trading was to enable farmers to hedge their price risk. However, this objective has remained a distant dream. Futures trading in agricultural goods have neither resulted in price discovery nor benefitted the farmers in terms of securing higher prices for their produce.

The purported objective behind setting up modern, electronic commodity futures exchanges was to create technology-centric, regulated markets that were affordable and accessible, and propagated the benefits of 'price transparency', 'efficient transaction', 'risk hedging' and 'structured finance'. The expectation was to unlock value from the middle and bottom of the pyramid, change lives and empower the common man through next-generation technology platform. Unfortunately, the expectation is far from becoming a reality.

The writers of the document raise the question, -- though the futures exchanges are providing the latest technology for trading, how many market participants are in a position to use it? They say that small traders simply cannot afford to use algorithmic trading and other expensive technologies, which are frequently used by big players. This has resulted in fragmentation of the market and lack of level-playing field across all commodity futures exchanges.

There are currently 19 commodity derivatives exchanges in India. However, the bulk of trading (99.88%) is concentrated in the six national-level commodity exchanges.

Over the years, the composition of trading has dramatically changed in the Indian futures markets. For instance, agricultural commodities constituted 69 percent of total value of trade in 2004-2005 and the rest was in bullion and metals. In 2012-2013, the share of bullion and metals rose to 65 percent and agricultural commodities declined to 12 percent. The futures prices of bullion and metals are largely influenced by the movements in the international markets and foreign exchange rate.

The document also says that the Forward Markets Commission (FMC) has allowed trading of 113 commodity future contracts in the Indian markets. These include food grains (e.g., wheat and gram), edible oilseeds complexes (e.g., groundnut and cottonseed), spices (e.g., turmeric and pepper), fibers (e.g., cotton and jute) metals (e.g., gold and silver) energy (natural gas and crude oil) and other products such as guar seed. However, gold, silver, guar seed, pepper and gram are the prominently traded items in the Indian derivatives markets.

No Commodity derivatives trading is currently governed by the Forward Contract Regulation Act (FCRA) which prohibits option trading and OTC commodity derivatives. Presently, only exchange-traded commodity futures are allowed. Successive governments have shown interest in amending the FCRA, which would allow the introduction of new products such as commodity options and weather derivatives.

The document further points out that deliveries are not compulsory in Indian commodity futures markets. However, in India, a delivery provision is required to be made as otherwise a futures contract (without delivery provision) would be deemed to be a 'waging contract' under Indian Contract Act and, thus, void in principle.

The provision for delivery is included in futures trading to make sure that the futures prices in commodities are in sync with the actual price of underlying commodities traded in the spot markets. However, in reality, deliveries account for less that 0.1 percent of the total trading in futures contracts in India. Almost all contracts are traded not with the intention to take/give delivery but for purely speculative purposes and are settled in cash as per the Final Settlement Price (FSP).

In addition to speculative trading, there are other important factors responsible for low delivery volumes. These include accredited warehouses in the country, poor credibility of warehouse receipts, delivery centres (where the physical delivery of commodities needs to take place) located at distant locations which incur substantial transportation costs, different grades of underlying commodity (for instance, futures trading in rice is carried out in just one grade but over 30 grades of rice are grown in India), and myriad regulations imposed by state governments on the inventory and movement of the underlying commodity.

The staggered or early delivery system has been recently introduced in the Indian commodity futures markets to make futures trading more delivery centred and to reduce excessive speculation and price volatility, especially towards the contract maturity date. In staggered delivery system, the markets participants have the facility to liquidate their positions early (generally 15 days before the expiry of the contract). It requires traders to report their delivery intention 15 days before the close of the near-month contract.

Part II consists of following six chapters.

Chapter VIII: How Are The Indian Commodities Futures Markets Manipulated?

In this chapter, the document discusses the common fraudulent business practices. The document says that there are widespread allegations of circular trading by a small group of brokers to prop up the trading volumes at MCX. It has been pointed out by market analysts that some MCX members allegedly used hundreds of benami companies as well as bogus, forged or genuine PAN cards to open a maze of fraudulent dematerialized accounts. Besides, the growing trend of high trading volumes and low open interest is not healthy. A large number of transactions with low open interest is a signal that some cooperation is going on between the parties instead of actual trading. These undesirable activities are carried out for price manipulation and tax evasion purposes.

Circular trade helps to attract lay investors who believe that there is liquidity in the market, that the market is active and the price is correct. Circular trading helps fraudulent traders create false expectations that there is a lot of demand of particular futures contracts, and lures the small investors to trade in them. Once such investors enter the market, those involved in circular trading sell their positions at a higher price and get out while the investors who are not part of the circular trade lose their money.

The document further says that open interest is the total number of outstanding contracts that are held by market participants at the end of the day. It can also be defined as the total number of futures contracts or option contracts that have not yet been exercised, expired, or fulfilled by delivery. Open interest applies primarily to the futures market. Open interest is often used to measure trends and trend reversals for futures and options contracts. It measures the flow of money into the futures market. For each seller of a futures contract there must be a buyer of that contract.

The growing trend of high trading volumes and low open interest is not a healthy development in the Indian futures markets. Market observers believe that the average global volume of open interest in agriculture commodities is 30 percent and for non-agriculture commodities it is 40 percent. In contrast, the ratio between volume and open interest is much higher in the Indian commodity futures markets. The FMC has found huge disparity between the ratio of open interest and volume of trading in some commodities traded on national commodity exchanges.

The document also talks about how the profit and loss accounting in commodity futures trading leads to tax evasion. It says though the purported objectives behind the establishment of commodity derivatives market were price stability, poverty reduction and economic development in a market-

based economy, in reality these markets are being frequently used for price manipulation, tax evasion and gains through illicit means. There are plenty of instances where big traders and speculators have hijacked the futures trading platform to manipulate the prices and deprive the farmers, small traders, investors of their lifetime's earnings.

Even government is aware that commodity futures trading platforms are being used for tax evasion and recycling unaccounted money by misusing the various provisions under the Income-tax Act, which permits offsetting of speculative profits against speculative loss. This involves transactions through inactive or illiquid contracts to evade any trading risk. In a written reply to a parliamentary question on blatant misuse of commodity futures trading platforms for tax evasion and other illegal economic operations, the then Minister for Consumer Affairs, Food And Public Distribution, K.V. Thomas admitted that the FMC had received complaints regarding alleged artificial volumes and tax evasion transactions in respect of some contracts listed in one of the national exchanges.

Lack of effective regulation is the reason why dabba trading - a parallel variant of commodity futures trading - is mushrooming in different parts of India. Under this technique, derivatives are traded on an unregulated trading platform managed by a broker, while the reference prices are based on regulated futures exchanges. The broker collects the margin money in cash on the same terms as a futures trading but does not deposit the money in the clearing house of the commodity exchange as per the norms. On the final date of the contract, the counterparty gives or takes the difference and the account is settled. It is a form of betting without any formal set of rules or regulatory mechanism and is patronized by commodity brokers, traders, and underworld dons. Since there is no institution behind it, there is always risk that the broker himself goes broke and is not in a position to pay the investors who traded the contracts.

Dabba trading is officially banned but is still one of the major contributors of illicit money in the Indian economy. The volume of unofficial trade is at least 20-30 times the 'official' business in futures exchanges. Since the transaction costs are low, it attracts many small speculators. Raids on three commodity traders in Delhi promising extraordinary high returns revealed a big network across Delhi, Punjab, Haryana, Rajasthan, Uttar Pradesh, Bihar, Maharashtra and Andhra Pradesh. According to media reports, the fraudsters have developed innovative online dabba trading techniques to hoodwink the authorities and escape detection. A nationwide raid on Bansal Sharevest Services by the authorities revealed that this broking firm had installed 500 terminals with leased lines for dabba trading purposes across the country.

Some commodity exchange operators are using wash trading - a trading practice that involves selling and repurchasing substantially the same security for the purpose of increasing the price and creating the semblance of activity in the market. Wash trading is illegal and its purpose is to manipulate the market and prompt other investors into buying the position. Incidence of wash trading, circular trades and other fake trades rise steeply towards the end of every financial year to evade taxes, particularly in liquid contracts.

In the context of tax evasion, the document also refers to client code modification (CCM) and its use to evade taxes. Client code modification is a widespread fraudulent practice among commodity traders. It involves fund transfer from the accounts of big investors into the account of a small, unknown person who is made to invest in commodities on their behalf.

Misusing the provisions of CCM, the MCX reportedly accounted for 2,27,981 trades with a turnover of Rs. 45,614,40 crore from January 2010 to March 2012. During the same period, NCDEX did 53,314 transactions worth Rs. 15,474,65 crore while NMCE did 917 trades worth Rs. 55 crore.

The FMC investigations have revealed large scale misuse of CCM for massive tax evasion and money laundering. What is all the more surprising is that this illegal and fraudulent trade practice was going on without any timely interventions by the regulators and the central government.

Chapter IX: The Guar Futures Trading Scandal

In this chapter, the document says that most guar farmers sell their produce to traders at the farm gate and nearby markets. India is the largest producer of guar seed in the world and accounts for 80 percent of the world's total guar seed production. Of late, the global demand for guar gum is growing rapidly because of its use in 'hydraulic fracturing' (fracking in short) process to extract oil and gas from Shale. Almost 80 percent of the country's total gum production is exported to US, China and Europe. Since 2004, guar seed and guar gum contracts are being traded in the Indian commodity futures markets.

In the commodity futures markets, guar seed and guar gum prices rose at an extraordinary rate during the six months period between October 2011 and March 2012. The trading in guar gum was hitting the upper circuit almost every other day in the futures markets during February-March 2012. There is no denying the fact that strong export demand for guar products pushed up prices in the first four weeks but a 900 percent price increase cannot be attributed solely to this factor. The key factor behind the massive increase in guar prices was the excessive speculation.

The Forward Markets Commission found huge disparity between the ratio of open interest and the volume of trading in guar seed and guar gum contracts. The day trading volumes were far in excess of open interest, clearly indicating the pre-dominance of speculative trading in both commodities.

While referring to the manipulation of guar futures prices, the document says that betting on a strong export demand and limited domestic production, speculators and non-commercial players were able to corner a sizeable share of the guar futures trading by buying large number of futures contracts through related entities - with common postal and Internet Protocol addresses. This trading through related entities was deliberately carried out to manipulate the prices in a coordinated manner in future. The FMC as well as the commodity exchanges took no action at the time to stop these irregularities.

The market observers have noted the bulk of speculative buying in guar futures contracts was financed by non-bank finance companies, linked to financial conglomerates providing brokerage and unsecured lending to large traders.

In addition, large traders in the futures markets in collusion with spot market traders managed to hoard a sizeable portion of physical stocks and thereby created an artificial shortage in the spot markets. A large number of rogue brokers were also found to be involved in frequent client code modification (transferring a transaction from one client to another) for tax and regulatory avoidance purposes. In March 2012 alone, transactions worth Rs. 1,45,700 million (about $2,350 million) were reportedly involved in such practices.

Within a span of few weeks, speculators, non-commercial traders and day traders - who had no genuine interest in or exposure to the underlying commodity -- earned huge profits from trading in guar seed and guar gum futures contracts. According to media reports, the investigations carried out by FMC found that 4,490 entities were involved in guar gum price manipulation and they together made profits of Rs.12,910 million. The FMC investigations also found that major edible oil companies (e.g., Ruch Soya Industries and Betul Oils), which are not directly involved in guar production or processing businesses, also cornered huge profits by manipulating the prices of guar futures contracts.

The document further says that the guar farmers did not benefit from the steep hike in price. The majority of guar farmers are small farmers who sell the crop immediately after harvest and, therefore, do not store it in godowns/warehouses to benefit potential price increase in the future. On the contrary, guar farmers paid the heavy price for the price manipulation in the futures markets as they had to buy expensive guar seeds for their next crop.

Despite the widespread evidence of speculative feeding frenzy and price rigging practices in guar futures contracts. FMC and commodity exchanges took no action to stop these irregularities in the first three months (October-December 2011). It was only after the market abusive practices came to public notice, did the regulatory authorities wake up to ensure an orderly market. In late-January 2012, FMC announced the following regulatory measures:

- Additional margins on both buy and sell side were imposed to certain price volatility. Under the revised rules, a trader has to pay 65 percent margin upfront in cash before buying guar contracts.
- Clubbing of open positions of related entities was introduced to check price manipulation.
- Open positions limits (the number of contracts an individual can hold in an exchange) were reduced by 20 percent for both aggregate and near month futures contracts.
- No fresh positions were allowed in contracts expiring in January 2012.

In this context, the document points out that the FMC had rarely deployed such stringent measures in the futures markets in recent years. The regulatory measures had no significant effect on the speculative buying which was causing unusual price hike in guar futures contracts.

Savvy speculators managed to circumvent new regulations on position limits by trading guar contracts through related entities or in the accounts of small individual investors who were paid a token amount for allowing the use of their accounts for trading purposes.

When the new regulatory measures failed to rein in rampant speculative trading, FMC announced the suspension of futures trading in guar contracts on March 27, 2012. After the suspension of trading in futures contracts, the guar prices witnessed a sharp decline in the spot markets.

This is not the first time that speculators have distorted the guar futures prices. In 2006, a speculative buying frenzy in guar futures contracts was unleashed by big market players, which prompted the guar gum manufacturers and exporters to demand a complete ban on futures trading in the guar products.

In a scathing report on the widespread irregularities in the futures markets, the Parliamentary Standing Committee on Food, Consumer Affairs and Public Distribution observed that "powerful traders indulged in malpractices have no fear of the authority conferred on FMC under the Forward Contracts (Regulation) Act, 1952 nor are they bothered about the fine that can be imposed on them." The Parliamentary Committee strongly recommended that the cases of market manipulation should be handed over to the Central Bureau of Investigation (CBI) for thorough investigations. **To sum up, the guar scandal reveals how price manipulation in the Indian commodity futures markets can cost farmers and consumers dearly due to poor regulation and supervision.**

Chapter X: The NSEL Payment Scam

In this chapter, the document talks about the unfolding of the NSEL payment scam. It says that the Rs. 55 billion payment crisis at the National Spot Exchange Limited (NSEL) was triggered when it suspending trading of all one-day contracts on July 31, 2013. Controlled by Financial Technologies Limited, NSEL was born and allowed to operate only in the spot market. It was specially forbidden to offer forward or futures contracts. NSEL operated with regulatory exemption from the government, based on riders such as a ban on long-dated contracts and short-selling. But it allowed trading that was never approved by the government and that, in the eyes of many, virtually offered assured returns and helped boost volumes till the Ministry of Consumer Affairs stepped in July 2013, forcing NSEL to provide an undertaking that it would not launch any more contracts and that all existing contracts would be settled on due dates, besides stopping a payout to brokers. This led to a payment settlement crisis.

The most astonishing fact is that a market for immediate trading of commodities, the equivalent of a cash market in stocks, begun functioning as a forward market with tax payment and settlement rules.

Apparently, every transaction of buy and sell was paired with one leg beyond the specialized spot settlement cycle of two days after the trade (T+2). And the NSEL contracts settled within T+10 days were defined as 'spot', but could be carried forward, dodging the FMC regulations, with settlements going as far as ahead as T+35. As a result, the buyers benefitted from an increase in the value of their positions and they booked profits by selling at higher price within the T+35 period. NSEL launched a number of one-day forward contracts, but some of them were being settled as many as 36 days after the date of transaction.

It has become evident through multiple sources - including regulators, brokers and users of NSEL products - that most of the trading on the exchange centred on the so-called pair trades to generate annualized returns of 14 - 15 percent, without assuming any commodity price risk. Paired trade worked as follows. Investors bought a near-term settlement contract with a T+2 settlement period, and another one with a T+36 settlement was sold simultaneously. The difference in the price of the two contracts - namely, the interest paid to defer payment - was the return for the financier. When the near-term contract was settled, investors became the owners of a warehouse receipt of the commodity purchased. This was effectively pledged to the exchange for the second leg of the transaction - the delivery transaction to be settled 36 days later. However, the buyer of the 36-day contract (effectively, a borrower of funds if he also sold the near-term contract) was levied inadequate margins for the risk he posed to the system.

Referring the modus operandi, the document says that in June 2007, when the central government granted a license to NSEL, the underlying idea was that the futures market could not function efficiently without an efficient physical market.

Spot exchanges were supposed to be an electronic market where a farmer or trader could discover the prices of commodities and buy or sell goods immediately to anyone across the country. All contracts on the exchange were compulsory delivery contracts, i.e., at the end of the day the seller had to deliver commodities and the buyers had to take delivery of what was owed to each other at the end of the day (intra-day squaring off was allowed). Another mandatory requirement was 'ready contracts', meaning a contract which provides for the delivery of goods and the payment of a price, either immediately, or within a period not exceeding 11 days (T+10 contract) after the date of the contract. The seller had to deliver the commodities and the buyer had to take delivery of what was owed to each other at the end of the day.

NSEL's mandate was only to offer a spot trading platform. It is not recognized forward contract exchange like MCX. But, as shady package deal, traders were allegedly allowed to buy contracts in NSEL and sell the same on MCX - which is not the same thing. Also, it was operating T+25 contracts right from the beginning and pairing trade of T+2 and T+25 or T+2 and T+35 - which had no legal basis. The more-than-11 day contracts' tenure was illegal. NSEL started offering assured returns of 12-15 percent; as a result, its business boomed. It achieved a turnover of Rs. 21,820 million by the end of the first year in 2009, and its daily turnover touched Rs. 10,000 million. Another blatantly illegal but popular product was vyaj badla, an ingenious risk-free guaranteed return scheme where the financier held a warehouse receipt for the goods and NSEL stood counter-guarantee for any failed transaction.

The document points out that NSEL violations were first noticed in May 2011, when a sub-committee of the Reserve Bank of India (RBI) and Ministry of Consumer Affairs officials was apprised about the lack of regularity measures in the spot exchanges. But nothing happened for eight months. Though the central government woke up and brought NSEL under the purview of FMC in February 2012, yet nothing much changed on the ground except NSEL was made to furnish weekly and fortnightly trade data. Even as early as February 21, 2012, FMC knew of 55 contracts having a settlement period of more than 11 days, and instances of short-selling. Why is it that despite the Ministry of Consumer Affairs and FMC finding large scale violations as early as April 27, 2012, NSEL was allowed to continue for 16 months, till August 6, 2013? For close two years, the government kept dilly-dallying. Though the FMC submitted a draft legislation for regulating spot exchanges to the Ministry, and the Ministry issued a show cause notice to NSEL on April 27, 2012. There was no follow-up action.

The document further says that behind trading of contracts was NSEL's settlement guarantee fund (SGF) and therefore it was legally bound to pay if there was a default by counterparties. The purpose of the SGF is to ensure that all market participants are not affected in case of default. It is alarming as how the SGF (comprising cash, fixed deposit receipts, bank guarantees and other assets) shrunk from Rs. 8,395 million on July 29 to Rs. 570 million on August 7, 2013. No convincing arguments have been put forward by NSEL to explain how the fund corpus had dwindled away. It is widely believed that payments were made to a chosen few investors in an arbitrary manner.

The fact that 25 to 50-day futures contracts were being traded on NSEL and that some structured products offered by brokers on the exchange were offering assured annual return of 14-15 percent to investors, was publicly known but no timely action was taken by FMC and the central government to stop this malpractices. At many accredited warehouses, the stocks claimed by NSEL appear to be suspect, as receipts issued by them turned out to be forged. In some cases, the stocks were pledged to more than one financial institution. In most cases, actual stocks do not tally with the quantities mentioned in the warehouse receipts.

At the heart of the unfolding developments at NSEL is the shoddy regulation of the commodity markets. Paul Joseph, former Director (Stock Ecxhanges0 in the Department of Economic Affairs, retired in 2008 and soon joined Jignesh Shah (the promoter of NSEL). He signed a notification dated June 5, 2007, which helped NSEL take advantage of the technicality of 'one-day forward' contracts and launch spot markets across the country, NSEL went live on October 15, 2008.

Though the plea taken was that the amendment would help farmers get better prices, as the regional terminals where farmers bring their produce are controlled by cartels that beat down prices, in actual terms it placed the functioning and control of NSEL spot exchanges outside the purview of the FMC and without assigning clear-cut powers to the central or state governments to regulate the trading of such contracts. 'Ready delivery' contracts are outside the purview of Forward Contracts (Regulation) Act.

Chapter XI: The Regulatory Issues

The document says that in a country like India where non-enforcement of regulations is a widespread phenomenon, it is equally important that regulation of commodity futures markets is followed by better rule enforcement, supervision and monitoring. However, the complexity and non-transparency of the derivatives markets prevents sufficient public and political pressure to address the problems.

At present, the regulation of commodity futures markets is carried out through a three-tiered regulatory structure - the central government, the Forward Markets Commission (FMC) and the commodity exchanges.

Apart from determining regulatory policies, the central government has the legislative powers to pass, amend and repeal laws related to futures trading in India subject to the approval of the Parliament. In the aftermath of NSEL payment crisis in 2013, the Ministry of Finance has been appointed as the nodal ministry to deal with legislative matters. Earlier, the Ministry of Consumer Affairs, Food and Public Distribution was dealing with these matters.

The FMC, headquartered at Mumbai, is the regulatory and supervisory authority for commodity futures market in India. It is a statutory body set up under Forward Contracts (Regulation) Act, 1952. Over the years, most of the regulatory powers of the central government have been delegated to FMC. It now functions under the administrative control of the Ministry of Finance.

The document also talks about the key regulatory tools used by FMC in the recent past. It says that in the wake of growing public criticism over excessive speculation and market manipulation in the Indian commodity futures markets. FMC has imposed a series of new regulatory measures since June 2012:

- Introduction of staggered delivery system.
- Imposition of special margin to reduce leverage and curb excessive speculative activity in specified commodities. In September 2013, for instance, FMC imposed an additions special margin of 10 percent on futures contracts of guar gum.
- Limit on price fluctuation (daily/weekly) to prevent abrupt movements in prices.
- Based on production data and market conditions, reduction in open position limits to prevent speculative trading.
- No contract in the lean season for agricultural commodities (e.g., permission was not granted for February and March 2013 contracts in gram).
- Imposition of additional margin based on price volatility and market development.

While talking about the key regulatory and governance gaps in Indian commodity futures markets, the document says that although trading in commodity futures market has witnessed tremendous growth since 2005, the regulatory provisions of the Forward Contracts (Regulation) Act, 1952, have not changed significantly since its enactment in 1952. Hence, there is an urgent need to upgrade the current regulatory system governing the commodity futures market.

Unlike the equity markets regulatory authority (Securities and Exchange Board of India) the commodity futures regulatory authority is not autonomous. The FMC does not have independent powers to regulate all market intermediaries and it relies on commodity exchanges for market monitoring and surveillance activities. Also, the law makers have too little information about the working and the regulatory framework of the commodity futures exchanges.

In addition, the existing penalty provisions are grossly inadequate and not in tune with the current trading volume in the Indian commodity derivatives markets. It may sound astonishing that the FMC - which regulates billions of dollars' worth of commodity trade - does not have the power to directly impose a financial penalty on traders. Now, only a maximum penalty of Rs. 1,000 can be imposed on market participants by it, and through court orders on conviction. A financial penalty of a mere Rs. 1,000 (enforced through a lengthy court process) does not deter potential offenders in the commodity markets. Also, FMC does not enjoy independent search and seizure powers. It has to rely on local police force.

In the aftermath of guar futures trading scandal, FMC introduced additional regulatory measures such as staggered delivery system, declaration of warehouse stocks and changes in the validity period for agricultural commodities. These measures are indeed welcome but not adequate to rein in rampant malpractices in the Indian futures markets. What is required is a complete overhaul of current legal and institutional framework governing the Indian commodity futures markets. The FMC should also introduce strong consumer protection norms in the Indian markets.

Beginner's Guide to Commodities Futures Trading in India

Published by:

TradingPicks.com

Bird's Eye View

This 3-page leaflet is in the form of questionnaire form telling in brief the nitty-gritty of future trading in Commodity. It begins with the introduction of the subject.

It says that Indian markets have recently thrown open a new avenue for retail investors and traders to participate: commodity derivatives. For those who want to diversify their portfolios beyond shares, bonds and real estate, commodities are the best option.

Till some months ago, this wouldn't have made sense. For retail investors could have done very little to actually invest in commodities such as gold and silver -- or oilseeds in the futures market. This was nearly impossible in commodities except for gold and silver as there was practically no retail avenue for punting in commodities.

However, with the setting up of three multi-commodity exchanges in the country, retail investors can now trade in commodity futures without having physical stocks!

Commodities actually offer immense potential to become a separate asset class for market-savvy investors, arbitrageurs and speculators. Retail investors, who claim to understand the equity markets may find commodities an unfathomable market. But commodities are easy to understand as far as fundamentals of demand and supply are concerned. Retail investors should understand the risks and advantages of trading in commodities futures before taking a leap. Historically, pricing in commodities futures has been less volatile compared with equity and bonds, thus providing an efficient portfolio diversification option.

In fact, the size of the commodities markets in India is also quite significant. Of the country's GDP of Rs 13,20,730 crore (Rs 13,207.3 billion), commodities related (and dependent) industries constitute about 58 per cent.

Currently, the various commodities across the country clock an annual turnover of Rs 1,40,000 crore (Rs 1,400 billion). With the introduction of futures trading, the size of the commodities market grows many folds here on. Like any other market, the one for commodity futures plays a valuable role in information pooling and risk sharing. The market mediates between buyers and sellers of commodities, and facilitates decisions related to storage and consumption of commodities. In the process, they make the underlying market more liquid.

Here's how a retail investor can get started:

Where do I need to go to trade in commodity futures?

You have three options - the National Commodity and Derivative Exchange, the Multi Commodity Exchange of India Ltd and the National Multi Commodity Exchange of India Ltd. All three have electronic trading and settlement systems and a national presence.

How do I choose my broker?

Several already-established equity brokers have sought membership with NCDEX and MCX. The likes of Refco Sify Securities, SSKI (Sharekhan) and ICICIcommtrade (ICICIdirect), ISJ Comdesk (ISJ Securities) and Sunidhi Consultancy are already offering commodity futures services. Some of them also offer trading through Internet just like the way they offer equities. You can also get a list of more members from the respective exchanges and decide upon the broker you want to choose from.

What is the minimum investment needed?

You can have an amount as low as Rs 5,000. All you need is money for margins payable upfront to exchanges through brokers. The margins range from 5-10 per cent of the value of the commodity contract. While you can start off trading at Rs 5,000 with ISJ Commtrade other brokers have different packages for clients.

For trading in bullion, that is, gold and silver, the minimum amount required is Rs 650 and Rs 950 for on the current price of approximately Rs 65,00 for gold for one trading unit (10 gm) and about Rs 9,500 for silver (one kg).

The prices and trading lots in agricultural commodities vary from exchange to exchange (in kg, quintals or tonnes), but again the minimum funds required to begin will be approximately Rs 5,000.

Do I have to give delivery or settle in cash?

You can do both. All the exchanges have both systems - cash and delivery mechanisms. The choice is yours. If you want your contract to be cash settled, you have to indicate at the time of placing the order that you don't intend to deliver the item.

If you plan to take or make delivery, you need to have the required warehouse receipts. The option to settle in cash or through delivery can be changed as many times as one wants till the last day of the expiry of the contract.

What do I need to start trading in commodity futures?

As of now you will need only one bank account. You will need a separate commodity demat account from the National Securities Depository Ltd to trade on the NCDEX just like in stocks.

What are the other requirements at broker level?

You will have to enter into a normal account agreements with the broker. These include the procedure of the Know Your Client format that exist in equity trading and terms of conditions of the exchanges and broker. Besides you will need to give you details such as PAN no., bank account no, etc.

What are the brokerage and transaction charges?

The brokerage charges range from 0.10-0.25 per cent of the contract value. Transaction charges range between Rs 6 and Rs 10 per lakh/per contract. The brokerage will be different for different commodities. It will also differ based on trading transactions and delivery transactions. In case of a contract resulting in delivery, the brokerage can be 0.25 - 1 per cent of the contract value. The brokerage cannot exceed the maximum limit specified by the exchanges.

Where do I look for information on commodities?

Daily financial newspapers carry spot prices and relevant news and articles on most commodities. Besides, there are specialised magazines on agricultural commodities and metals available for subscription. Brokers also provide research and analysis support.

But the information easiest to access is from websites. Though many websites are subscription-based, a few also offer information for free. You can surf the web and narrow down you search.

Who is the regulator?

The exchanges are regulated by the Forward Markets Commission. Unlike the equity markets, brokers don't need to register themselves with the regulator.

The FMC deals with exchange administration and will seek to inspect the books of brokers only if foul practices are suspected or if the exchanges themselves fail to take action. In a sense, therefore, the commodity exchanges are more self-regulating than stock exchanges. But this could change if retail participation in commodities grows substantially.

Who are the players in commodity derivatives?

The commodities market will have three broad categories of market participants apart from brokers and the exchange administration - hedgers, speculators and arbitrageurs. Brokers will intermediate, facilitating hedgers and speculators.

Hedgers are essentially players with an underlying risk in a commodity - they may be either producers or consumers who want to transfer the price-risk onto the market.

Producer-hedgers are those who want to mitigate the risk of prices declining by the time they actually produce their commodity for sale in the market; consumer hedgers would want to do the opposite.

For example, if you are a jewellery company with export orders at fixed prices, you might want to buy gold futures to lock into current prices. Investors and traders wanting to benefit or profit from price variations are essentially speculators. They serve as counterparties to hedgers and accept the risk offered by the hedgers in a bid to gain from favourable price changes.

In which commodities can I trade?

Though the government has essentially made almost all commodities eligible for futures trading, the nationwide exchanges have earmarked only a select few for starters. While the NMCE has most major agricultural commodities and metals under its fold, the NCDEX, has a large number of agriculture, metal and energy commodities. MCX also offers many commodities for futures trading.

Do I have to pay sales tax on all trades? Is registration mandatory?

No. If the trade is squared off no sales tax is applicable. The sales tax is applicable only in case of trade resulting into delivery. Normally it is the seller's responsibility to collect and pay sales tax.

The sales tax is applicable at the place of delivery. Those who are willing to opt for physical delivery need to have sales tax registration number.

What happens if there is any default?

Both the exchanges, NCDEX and MCX, maintain settlement guarantee funds. The exchanges have a penalty clause in case of any default by any member. There is also a separate arbitration panel of exchanges.

Are any additional margin/brokerage/charges imposed in case I want to take delivery of goods?

Yes. In case of delivery, the margin during the delivery period increases to 20-25 per cent of the contract value. The member/ broker will levy extra charges in case of trades resulting in delivery.

Is stamp duty levied in commodity contracts? What are the stamp duty rates?

As of now, there is no stamp duty applicable for commodity futures that have contract notes generated in electronic form. However, in case of delivery, the stamp duty will be applicable according to the prescribed laws of the state the investor trades in. This is applicable in similar fashion as in stock market.

How much margin is applicable in the commodities market?

As in stocks, in commodities also the margin is calculated by (value at risk) VaR system. Normally it is between 5 per cent and 10 per cent of the contract value.

The margin is different for each commodity. Just like in equities, in commodities also there is a system of initial margin and mark-to-market margin. The margin keeps changing depending on the change in price and volatility.

Are there circuit filters?

Yes, the exchanges have circuit filters in place. The filters vary from commodity to commodity but the maximum individual commodity circuit filter is 6 per cent. The price of any commodity that fluctuates either way beyond its limit will immediately call for circuit breaker.

Public Services Under Attack

TTIP, CETA, and the secretive collusion between business lobbyists and trade negotiators

By:

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Bird's Eye View

The 46-page document, besides Executive Summary, is divided into five chapters.

Chapter-I gives the Introduction. Chapter II deals with "Dangerous Liaisons: business, services, and trade"; Chapter III refers to "Business wish-list for Europe's public services"; Chapter IV talks about "Rolling out the red carpet: how the EU bows to corporate demands"; Chapter V carries "Conclusion: democracy and social justice, not trade deals threatening public services".

Executive Summary

The document says that public services in the European Union (EU) are under threat from international trade negotiations that endanger governments' ability to regulate and citizens' right to access basic services like water, health, and energy, for the sake of corporate profits. The EU's CETA (Comprehensive Economic and Trade Agreement) with Canada' whose ratification could begin in 2016 and TTIP (Transatlantic Trade and Investment Partnership) treaty under negotiation with United States are the latest culmination in such efforts. In a worst case scenario, they could lock in public services into a commercialization from which they will not recover - no matter how damaging the results may be.

The document sheds some light on the secretive collusion between big business and trade negotiators in the making of the EU's international trade deals. It shows the aggressive agenda of services corporations with regard to TTIP and CETA, pushing for far-reaching market opening in areas such as health, cultural and postal services, and water, which would allow them to enter and dominate the markets. And it shows how those in charge of EU trade negotiations are rolling out the red carpet for the services industry, with both the consolidated CETA agreement published in September 2014, as well as drafts of TTIP chapters and internal negotiation documents that reflect the wish-lists of corporate lobbyists.

Key findings of the document are:

1. TTIP and CETA show clear hallmarks of being influenced by the same corporate lobby groups working in the area of services that have been built over the past decades during previous trade talks.
2. The relationship between industry and the European Commission is bi-directional, with the Commission actively stimulating business lobbying around its trade negotiations. This has been characterized as 'reserve lobbying', ie, "the public authority lobbies business to lobby itself".
3. **The business lobby has achieved a huge success as CETA is set to become the first EU agreement with the 'negative list' approach for services commitments.** This means that all services are subject to liberalization unless an explicit exception is made. It marks a radical departure from the positive lists used so far in EU trade deals which contain only those services which governments have agreed to liberalize, leaving other sectors unaffected.
4. Big business has successfully lobbied against the exemption of public services from CETA and TTIP as both agreements apply to virtually all services.
5. Probably the biggest threat to public services comes from the far-reaching investment protection provisions enshrined in CETA and also foreseen for TTIP.
6. The different reservations and exemptions in CETA and TTIP are inadequate to effectively protect the public sector and democratic decision-making over how to organize it.
7. **The European Commission follows industry demands to lock in present and future liberalizations and privatizations of public services, for instance, via the dangerous 'standstill' and 'ratchet'**

mechanisms - even when past decisions have turned out as failures. This could threaten the growing trend of re-municipalization of water services (in France, Germany, Italy, Spain, Sweden, and Hungary), energy grids (in Germany and Finland), and transport services (in the UK and France).

8. **Giving into corporate demands for unfettered access to government procurement could restrict governments' ability to support local and not-for-profit providers and foster the outsourcing of public sector jobs to private firms,** where staffs are often forced to do the same work with worse pay and working conditions.
9. Both CETA and TTIP threaten to liberalize health and social care, making it difficult to adopt new regulations in the sector.
10. **The EU's most recent draft TTIO services text severely restricts the use of universal service obligations (USOs) and curbs competition by public postal operators,** mirroring the wishes of big courier companies such as UPS or FedEx. USOs, such as daily delivery of mail to remote areas without extra charges, aim at guaranteeing universal access to basic services at affordable prices.
11. TTIO and CETA threaten to limit the freedom of public utilities to produce and distribute energy according to public interest goals, for example, by supporting renewable to combat climate change.
12. **The US is eyeing the opening up of the education market via TTIP -** from management training, and language courses, to high school admission tests. US education firms on the European market such as Laureate Education, the Apollo Group, and the Kaplan Group could benefit as much as German media conglomerate Bertelsmann, which has recently bought a stake in US-based online education provider.
13. The US film industry wants TTIP to remove European content quotas and other support schemes for the local film industry, (for example, in Poland, France, Spain, and Italy).
14. Financial investors such as BlackRock engaged in European public services could use TTIP and CETA provisions on financial services and investment protection to defend their interests against 'burdensome' regulations. For example, to improve working conditions in the long term care sector.
15. **US services companies are also lobbying for TTIP to tackle 'trade barriers' such as labour regulations.** The report says what is at stake in trade agreements such as TTIP and CETA is our right to vital services, and more, it is about our ability to steer services of all kinds to the benefit of society at large. If left to their own course, trade negotiations will eventually make it impossible to implement decisions for the common good.

One measure to effectively protect public services from the great trade attack would be a full and unequivocal exclusion of all public services from any EU trade agreements and negotiations. As long as TTIP and CETA do not protect the ability to regulate in the public interest, they have to be rejected.

In the **Introduction**, the document points out that Europe's public services, from health to education, to social welfare, and beyond, are under threat from the EU's free trade agreements with Canada and the United States of America. While the ratification of the EU-Canada deal known as CETA (Comprehensive Economic and Trade Agreement) could begin in 2016, the EU-US deal TTIP (Transatlantic Trade and Investment Partnership) is currently under negotiation.

While there is growing concern in Europe, among citizens and some parliamentarians about the fate of public services under trade agreements, the EU's official negotiators are all too often siding with corporations to expand markets into public services - endangering citizens' access to basic services in the hunt for quick returns.

The European Union's secretive and largely corporate-driven approach to trade negotiations has attracted strong criticism from civil society. Research has revealed the close links between corporations and the European Commission's DG Trade, entrusted with leading trade negotiations for both CETA and TTIP on behalf of EU member states.

The resulting trade agreements threaten to be a veritable corporate wish-list of public services opened up to the free market. This will be a major blow to attempts to regulate markets in the public interest, taking decisions about these rules beyond elected parliamentary scrutiny and into the undemocratic realm of trade bureaucracy. The principle of profit will be enshrined in the deals, coming before public interest objectives to provide citizens with services key to their welfare and prospect in life.

The commission has been a reliable advocate for corporate interests, pushing for the very same liberalization of services and opening of markets as the European business community, whose views they have courted.

Despite the many assurances from the European Commission claiming public services will remain unaffected by TTIP and CETA, analyses of texts and drafts of these agreements prove the contrary. The recently published consolidated CETA text as well as the latest draft of the TTIP services and investment chapter contain many provisions that put public services in severe jeopardy, not to mention the aim of governing them in the public interest.

These dangers, coupled with the privileged access of business representatives to the Commission, are fueling growing public discontent with these trade agreements, with citizens increasingly questioning the democratic legitimacy of the European Union as whole.

The document says that the report sheds some light on the collusion between corporations and trade negotiators in the making of these deals. The imminent risks are examined in two main chapters: the first lays out the aggressive agenda of corporations with regards to TTIP and CETA, and the second shows how the European Commission is lending a helping hand to big corporations in these negotiations. But let's first take a brief look at the history of services in trade agreements and the role played by big business.

In the chapter **DANGEROUS LIAISONS: BUSINESS, SERVICES, AND TRADE,** the document says that many service sectors, from health to education, have been national affairs, requiring proper state regulation in order to be run in the interests of the public. But corporate lobbyists, spying a huge potential market, along with the collusion of trade negotiators, succeeded in overcoming policy-makers' reticence to exposing services to international competition.

The document further says that during the multilateral trade negotiations known as the Uruguay-Round (1986 - 1994) which led to the creation of the World Trade Organization (WTO), industry groups strongly advocated for the inclusion of a services agreement. Their efforts were rewarded: the General Agreement on Trade and Services (GATS) became one of the founding treaties of the WTO. Under GATS, WTO members committed to liberalization of a broad range of services, which included many traditional public services such as health, education, energy, social, sewerage, waste, postal, telecommunications, and cultural services.

Among the most influential GATS proponents were the US Chamber of Commerce and a newly created group, the US Coalition of Services Industries (CSI). Founded in 1982, CSI originally focused on the financial sector (banking and insurance) but soon developed into a broader alliance representing corporations also active in information technology, telecommunication, express delivery, retailing, life insurance, health, and film industry. Among its current members are multinationals as varied as AIG, Metlife, Citigroup, FedEX, UPS, IBM, Google, Walmart and the Walt Disney Company.

Meanwhile in 1985, at the urging of the European Commission itself, European services exporters created a lobby group dedicated to the Uruguay Round negotiations, the European Community Services Group (ECSG). The group was composed of national chambers of commerce, employer's federations, and national service coalitions such as the UK's LOTIS committee (Liberalization of Trade in Services).

Ahead of the new GATS talks of the WTO's 'Millennium Round' in 1999, then EU trade commissioner Leon Brittan initiated the creation of another business group, the European Services Forum (ESF), to which he said: " You are the driving force of the consultation system which we have established; my door is open for any matters of concern. Today, ESF's membership consists of national and European business associations such as MEDEF, France's largest employer federation, and the EU's most powerful corporate lobby group BusinessEurope, as well as CEOs and board members of several major companies including British Telecommunications and Deutsche Bank.

The document says that the examples of ECSG and ESF illustrate the special relationship between the European Commission and business circles, characterized as a kind of 'reverse lobbying', where EU officials actively request the close input of Europe's most powerful corporations, ie, "the public authority lobbies business to lobby itself". The Commission's 'reverse lobbying' has been very much part of the TTIP negotiations, as internal documents of ESF and DG Trade reveal.

According to an internal DG Trade memo, three of its officials also attended the ESF Policy Committee meeting of 25 February 2013"to present a state of play on the ongoing and future services negotiations". One of the officials outlined the main TTIP features, which include "regulatory co-operation" between EU and US bodies. 'Regulatory co-operation' is in theory the harmonizing or mutually recognizing of regulations such as those on food safety or approval of new chemicals, between the US and EU. The idea is that one sides' regulations should not pose any barrier to trade. The DG Trade memo emphasizes: "Industry must play an important role here as well, in suggesting areas where regulators should focus their effort in order to bring greatest benefit to industry".

When DG Trade officials are requesting corporations to advise them in targeting regulations troublesome to industry, it becomes clear that 'regulatory co-operation' is a very serious affair. It is a set of mechanisms to ensure that rules governing the economy - in this case the framework for services - are slowly made to be more market friendly. Officials from the EU and the US, together with stakeholders mainly from the business community, would be authorized to assess the potential trade impact of proposed new regulations on the bottom line of businesses, even before democratically elected bodies such as parliaments could have a say over them.

Regulatory co-operation enables the dismantling of current trade barriers and prevents the emergence of any new hurdles in the longer term. Therefore, the open invitation to business groups such as ESF to provide inputs for the regulatory cooperation mechanism has to be taken very seriously. It is an invitation to help construct the rules of the future.

In its constant concern for the well-being of European business, DG Trade directly approached corporate groups requesting inputs to the TTIP negotiations. According to an internal report of a Commission meeting with BusinessEurope's International Relations Committee held in October 2012, former EU Trade Commissioner Karel De Gucht "sent letters to several business federations encouraging them to identify the possible divergences in regulatory matters and above all, propose practical ways to solve them". By actively soliciting private sector input to shape the negotiations, the Commission has granted industry a privilege none of the other interest groups potentially affected by TTIP has so far enjoyed.

The Commission also encouraged the business community to do more to defend the alleged benefits of TTIP. Overall, the internal documents prove that the relationship between industry and the Commission is a bi-directional affair with DG Trade playing an active role in stimulating corporate lobbying. The Commission apparently perceives large corporations as its preferred constituency. But the privileged partnership between DG Trade and big business systematically disadvantages workers, consumers, and the European citizenry at large.

In chapter III titled **BUSINESS WISH-LIST FOR EUROPE'S PUBLIC SERVICES,** the document says that from the beginning, business lobbyists from both sides of the Atlantic have joined forces in order to push TTIP negotiators to open virtually all services sectors to sweeping to liberalization. To ensure maximum coverage of services in TTIP, the powerhouse lobby groups on both sides of the Atlantic, ESF and CSI, recommended a particular negotiation strategy known as a 'negative list' which means that all public services are subject to liberalization unless an explicit exception is made.

This 'list it or lose it' approach dramatically expands the scope of a trade agreement as governments make commitments in areas they might not even be aware of, such as new services emerging in the future. It makes a departure from the positive lists used so far in EU trade agreements containing only those services which governments have agreed to liberalization. At the same time, transatlantic lobby groups are trying to prevent negotiators from exempting any public services from the trade agreement. Their alarm belt started to ring in February 2015 when the European Parliament's Committee on International Trade (INTA) drafted a TTIP resolution asking for "an adequate carve-out of sensitive services such as public services and public utilities (including water, health, social security systems, and education) allowing national and local authorities enough room for manoeuvre to legislate in the public interest".

BusinessEurope, the umbrella group of European industry and employers, intervened and reminded parliamentarians of international commitments already undertaken in agreements such as GATS: "Instead of asking for carve out, there should be a reference to the need to comply with international rules". The European Service Forum echoed these demands: "ESF recommends maintaining as already committed in the GATS, the possibility of European private investors to invest in 'privately funded' education and health services".

Nevertheless, a more recent resolution approved by INTA on 28 May 2015 and submitted to the plenary for a final vote (Which were later postponed) still contained language demanding the exclusion of public services. But once again, BusinessEurope reacted immediately and sent an email to Members of the European Parliament saying: "We are concerned about the request to exclude public services - irrespective of how they are provided and funded - as the EU should not put in question its own multilateral commitments".

While talking about 'dismantling public health', the document says that the public health sector is one of the main targets of business lobbyists advocating for TTIP, hoping to capitalize on increasing health expenditure driven by aging populations in both the EU and the US, while public health sector continue to suffer from fiscal pressures and harsh austerity measures. For example, the powerful Washington-based Alliance for Healthcare Competitiveness (AHC) assembles companies and associations representing service providers, hospital operators, insurers, producers of pharmaceuticals and medical devices, as well as IT and logistics companies.

AHC complains that "today's world of health care services is highly restricted and fragmented", but an "open trading world for these services would create a large new flow of revenue into the United State". AHC also advocates for sweeping liberalizations of investment regulations inhabiting the expansion of private health providers in the EU. Economic needs tests are one of the many barriers TTIP is expected to remove. Subjecting the approval of establishments to criteria such as market saturation to prevent predatory competition, these tests are widely applied in the European health sectors. AHC, however, wants to get rid of them.

The business alliance repeatedly lashes out at state-owned enterprises (SOEs) and state-supported enterprise (SSEs) in the health sector, be they hospitals, care facilities, or health insurers. "Regulatory favouritism", as it puts it, only creates "market distortions" and prevents "taxpayers from getting the best deal". However, state-owned and state-supported enterprises such as public hospitals are virtually indispensable to guarantee equal access to health care for everyone, since private hospitals held to cherry-pick the better-off patients and those with lower health risks in order to maximize their profits.

The document further says that the Alliance of Healthcare Competitiveness (AHC) is particularly keen to achieve unfettered access for private health companies to government procurement in the EU. Public procurement can mean private companies being paid to offer direct provision of health services such as hospitals, purchases of pharmaceuticals and medical devices, construction contracts for health facilities, or the delegation of care services to private entities.

Governments often have thresholds, below which foreign companies are unable to bid for procurements, in order to support local providers. But health corporations want these thresholds drastically reduced, thus expanding their potential market. In the WTO's Government Procurement Agreement (GPA), the EU and the US have committed to a threshold of 130,000 special drawing rights (SDR) for the procurement of supplies and services. SDR is currency basket used by the International Monetary Fund (at the time of writing 1 SDR corresponds to 1.27 Euros). AHC, however, expects TTIP partners to accept an extreme reduction of this limit.

Mandatory tendering is an effective means for privatization by gradually increasing the amount of public health services transferred to commercial providers. Through outsourcing, companies take over the management or delivery of a whole raft of former public services including cleaning, catering, and facility management, as well as the provision of a range of clinical services and treatments. In an open public tender, contracting authorities may even offer the management of an entire hospital to for-profit providers. In many countries, the obligation to carry out competitive tendering has already led to the transfer of thousands of public sector jobs to private companies, with staff often forced to do the same jobs with considerably worse pay and working conditions.

In order to control their health expenditures, some European governments have implemented a range of cost-containing measures, including price controls for medicines. Price controls, however, may limit the profits of the pharmaceutical industry. For AHC, these cost-containing measures represent "onerous" non-tariff barriers which TTIP could help to dismantle. However, giving in to these demands to end or reduce price controls would hit public coffers and be a massive capitulation to pharmaceutical industry pressure. The danger in this area is very real. A proposal to do away with price controls is already negotiated in another trade deal, the Trans-Pacific Partnership (TPP) between the US, Australia, New Zealand, and Asian countries, and the pharmaceutical lobby has made it clear it would like to see TTIP include similar rules.

The document points out that financial industry is a major player in services liberalization. It says that the financial industry is not only one of the vocal advocates of trade liberalization but also a major force behind the privatization of public services. Lobby group AFME (Association of Financial Market in Europe) and its US counterpart SIFMA (Securities Industry and Financial Markets Association) issued a joint TTIP statement urging that "provisions for financial services must be an integral part of this partnership".

These lobby groups have many members engaged in privatized public services, including investment banks, asset management firms, insurance companies, public equity groups or real estate investment trusts (REITs). The financial industry is constantly developing specialized investment funds and other instruments targeting particularly the utilities sector (electricity, gas, and water services), healthcare (clinics, health insurance), education (college funding), infrastructure (transport and energy networks), and constructions and real estate (schools, hospitals, care homes). For example, US investment company Invesco, a SIFMA member, owns an important stake in the huge British healthcare provider CareUK. US private equity giant BlackRock's advisory council and its International Regulatory Strategy Group (IRSG), holds share in German healthcare company Fresenius.

In order to prepare its requests to the US Government for the TTIP negotiations, the European Commission in September 2013 circulated a detailed questionnaire to European industry for their particular interests in the US and the obstacles they encountered when trying to participate in public tenders. In its response, BusinessEurope provides a list of sectors where its members have commercial interests in US procurement, covering energy, health, and transport services (airports, roads, railways, metros, ports) as well as public utilities. The interest in public utilities focuses especially on the water sector.

Business Europe's overall objective is "that public procurement has to be fully open at all levels of government (federal, state, local level)". In addition, any local content requirement "should be eliminated". Meanwhile, US businesses direct essentially the same demands towards the EU. In a submission to the United States Trade Representative, the American Chamber of Commerce to the EU (AmCham EU) attacked a proposed EU regulation on the access of third-country suppliers to public tenders in the European internal market. But bowing to this business demands would further restrict contracting authorities' ability to avoid competitive tenders in order to retain services within the public sector. Limiting the in-house option, ie constraining the ability to keep services within the public sector, could increase the risk of outsourcing ever more public sector jobs to private companies and of impairing equal access to affordable public services.

The document further says that business groups are also advocating for rules on public-private partnerships (PPPs) to be introduced in TTIP. PPPs are contracts between governments and private companies under which companies finance, build, and operate elements of a public service and get repaid over a number of years, either through charges paid by users or by payments from the state. However, they can end up being a far more expensive option than the conventional public spending model. Nowadays, the main motivation for governments pursuing PPPs is to bypass their own neoliberal austerity measures constraining public borrowing. Although governments remain obliged to pay for the investments made under such partnerships, the accounting rules allow PPPs to be treated as private borrowing, enabling governments to shift their liabilities off public accounts.

In Europe, the majority of PPPs have been used to construct roads, railways, hospitals, schools, and other public buildings. However, PPPs are generally far from expensive than investments financed by public borrowing. Due to the ability of the state to raise taxes, the risk of defaulting on its debts is pretty low. By contrast, lending to private companies is far more risky as any of them may go bankrupt. Therefore, lenders usually charge higher interest rates on private sector loans than on public sector loans. In addition to the higher interest rates, private companies have to pay dividends to the shareholders in a PPP project, increasing the costs even further.

Large courier companies have traditionally lobbied trade negotiators to open world markets particularly for the express delivery of parcels and other mail items, in competition with national post services. Consequently, UPS, and US-based global courier company, welcomes the launch of the EU-US negotiations: "Europe represents UPS' largest market and investment outside North America, giving the TTIP critical value in terms of our ability to continue investing in both economies". An ambitious agreement "could boost our trading volume by 131 million packages" over 10 years. UPS advocates for commitments "to ensure market access and a level playing field for express delivery services (EDS)". However, government-supported national postal operators stand in the way of such a leveling exercise.

Many national postal operators which have been granted a public monopoly do not follow a profit motive. Generally, in return for the monopoly position they are obliged to fulfill certain universal service obligations (USOs) like daily delivery of mail also in remote areas without extra charges. For many public enterprises, also beyond the postal sector, cross-subsidies can be an important tool to guarantee universal access to basic services at affordable prices. This is particularly true for multi-utilities performing several tasks such as the provision of waste, water, energy, or transport services. It should be noted here that - despite past liberalizations and privatizations in the postal sector (most recently in Portugal and UK) - many EU member states still own their national public postal operators. In the majority of cases governments retain 100 percent ownership, in some other cases they hold a smaller share. Thus far, only three EU member states have completely sold off their stake in former public postal companies (the Netherlands, Malta, and Portugal). Therefore, all countries where governments retain ownership rights in their national postal operators or impose specific universal service obligations could be affected by TTIP when negotiations bow to the pressure of transnational courier companies.

The document further says that the Motion Picture Association of America (MPAA), representing the US film industry, also hopes for broader market access in the EU. To achieve this, the business association opposes any "upfront, blanket sectoral exclusions" - naturally their concern is the culture and entertainment sectors - in the TTIP talks. Instead, negotiator should strive for "a comprehensive agreement, devoid of sectoral curve-outs". Excluding cultural services particularly in the audio visual sector from trade negotiations - a regular demand of successive French governments - runs counter to the export interests of Hollywood's studio already dominating the world's movie markets. MPAA also seeks to remove European support schemes for the local film industry. Poland's taxes on box office and on DVD sales to finance subsidies for Polish and European films unfairly burden MPAA member companies with the cost of financing the government's cultural policy". The lobby also questions France's taxes aimed at supporting local film producers.

The document then refers to **future proofing TTIP: digital trade in public services**. It says that industry groups are pushing for a kind of "future-proofed" TTIP agreement, liberalizing by default any new services which might emerge due to technological change, no matter what form they might take. Future-proofing TTIP by approving any new service which emerges, for instance, over the internet, poses particular threats for public services such as health and education. The Alliance for Healthcare Competitiveness for example demands the dismantling of burdens on the "cross-border provision via telemedicine" (telemedicine is the remote diagnosis and treatment of patients by means of telecommunications technology). But authorizing any novel treatment available via telemedicine without proper risk assessment might put patients' lives in danger and increase healthcare costs. Equally, permitting online courses without proper assessments could endanger the quality of education and academic degrees.

While talking about **Locking in privatization**, the document says that beyond prising open services markets, one of the central features of the trade agreements such as TTIP and CETA is their capacity to effectively lock in previous and future liberalizations and privatizations - regardless of any government that gets voted in or what its mandate or policies might be. Apart from 'standstill' clauses irreversibly binding existing policies, business groups further demand the inclusion of a so-called 'ratchet' provision which would effectively lock in future deregulations.

The European Services Forum describes the rationale behind these demands: "The standstill and ratchet clauses are tools that ensure spreading of trade liberalization and allow avoiding the necessity to renegotiate outdated agreements". Any civil society initiatives trying to undo neoliberal privatization policies implemented in the past would be futile in all the sectors covered by the standstill clause.

But locking in current and future policies is particularly harmful when deregulations turn out to be a failure, as, for instance, the liberalization of capital markets which deepened the recent financial crisis. Efforts to reverse course and reregulate previously liberalized sectors under these kinds of circumstances may then be rejected as potential treaty violations. Similarly many welfare-enhancing measures could also be thwarted: containing the expansion of private health insurance. In the water sector, France is spearheading this trend with 63 remunicipalizations of water works completed in the past five years alone.

The document also says that 'protecting investment' means 'endangering welfare'. It says that business lobbies are united in their call to have a broad investment protection chapter in TTIP, including the highly controversial Investor-State Dispute Settlement mechanism (ISDS), granting foreign investors the exclusive right to bypass national courts and sue governments before private international tribunals. One of the overcharging corporate aims is to prevent government from any regulatory charges limiting private profits. The price states have to pay for backtracking from liberalization and privatization will be as high as possible. The US Chamber of Commerce, for instance, calls for the "right to establish and operate investments on a non-discriminatory basis, across the full range of economic sectors, including services).

In chapter IV titled **ROLLING OUT THE RED CARPET: How the EU Bows to Corporate Demands**, the document says that over the course of the TTIP negotiations, the European Commission has provided many assurances to concerned citizens that public services would remain unaffected by TTIP and CETA. In the March 2015, EU Trade Commissioner Cecilla Malmstrom and US Trade Representative Michael Froman even issued a joint statement on public services, claiming that US and EU trade agreements would neither require governments to privatize services nor prevent them from expanding the services they supply to the public.

But the document points out that heeding the demands of the business lobby, CETA and TTIP apply to virtually all public services. A very limited exemption only exists for services" supplied in the exercise of government authority". But to qualify for this exemption a service has to be carried out "neither on a commercial basis nor in competition with one or more economic operators. Yet nowadays, in virtually all traditional public sectors private companies exist alongside public suppliers - often resulting in fierce competition between the two.

The business lobby achieved huge success as CETA is set to become the first EU trade agreement where the EU uses the 'negative list' approach for its services and investment commitments. By default, all measures not listed in the EU's schedule of commitments may be subject to the liberalization provisions of the agreement, unless specific reservations are taken out. The European Services Forum (ESF) was highly delighted when it learned that the EU's Trade Policy Committee (TPC) gave the green light for a negative list approach in CETA.

A leaked document outlining the European Union's TTIP requests to the United States under the procurement chapter reveals that the Commission is also fulfilling industry demands to include public private partnerships (PPP) in the negotiations. The Commission closely follows BusinessEurope's request to clarify the application of PPPs by proposing an additional TTIP annex dedicated to "clarifications on the notion of public private partnership contracts".

The document further says that Commission document explains that in the EU the notion of public-private partnerships also applies to the very sensitive issue of services concessions. European civil society strongly contested the inclusion of services concessions in the recently approved package of EU procurement directives. The European Citizen Initiative (ECI) "Right2Water" succeeded in achieving at least the exclusion of water from the concessions as a whole have become a topic of the TTIP negotiations. According to a report of Germany's Economics Ministry to the German Parliament on the ninth round of TTIP negotiations held in April 2015 in New York, "the EU envisages specific commitments on services concessions in its market access lists."

TTIP could therefore lead to a dangerous expansion of EU liberalization commitments to the United States going far beyond those already made in the framework of the WTO's Government Procurement Agreement (GPA) - plurilateral treaty signed by 15 parties, including the EU, the US, and Canada. While the EU already committed, amongst others, construction services under the GPA, it still upholds several important restrictions to US companies. For instance, US suppliers do not enjoy a right to participate in services procured by sub-central government entities and utilities or in tenders offering public works concessions. Yet, all these barriers might now fall.

The US request could even lead to changes in current EU law, as an internal Commission report to the European Council's Trade Policy Committee (TPC) on the fourth TTIP round held March 2014 reveals. According to the internal Commission report summarizing the negotiations, the "US firmly pointed to its request for lower thresholds" for central government purchases, "without recognizing the EU point that this would require a change of the EU directives". Giving in to this US demand could further restrict contracting authorities' leeway to avoid competitive transatlantic tenders and to keep services within the public sector. Limiting the in-house option would accelerate the outsourcing of public sector jobs to private companies and the deterioration of working conditions.

The EU Commission also follows industry demands concerning the dangerous standstill and ratchet mechanisms locking in present and future liberalization and privatization. The EU, for instance, included a very narrow market access reservation for postal services in its Annex 1 under CETA. Due to the standstill mechanism, any legislation extending the activities of public postal operators beyond the activities mentioned here may constitute a violation of CETA rules. The EU's July 2015 draft TTPI schedule is even worse as it does not contain the extremely modest reservation used in CETA, in addition, the TTIP draft has a section on postal and courier services closely mirroring the wishes of the big courier companies keen to curb competition by public postal operators.

This chapter also severely restricts the use of universal service obligations (USOs) imposed on postal companies in order to guarantee universal service delivery at affordable rates across the whole country. Given that a majority of EU member states continues to retain controlling stakes in their national post operators, it appears pretty risky to commit to such drastic limitations of policy space. It cannot be ruled out that a country changes its preferences, as might be the case after a change of government, and again wishes to extend the state's activities in the postal sector, for instance by allowing the national operator to expand its parcel services. But such policies would run counter to the TTIP commitments. Fearing for their profitable parcel business, large express delivery companies could push the US government to initiate proceedings against the EU under TTIP's state-state dispute settlement mechanism.

While talking about **'unprotected utilities of water'**, it says that the EU's schedules of commitments under CETA and the latest TTIP offer both contain the so-called 'public utilities clause' intended to provide some protection to public services. But this reservation contains numerous loopholes. First, it refers only to some of TTIP's market access commitments, not to the equally important obligations to ensure non-discrimination and investment protection. Second, the bulk of public services are provided neither as a 'public monopoly' nor as the 'exclusive right' of private suppliers. In fact, many services delegated private operators are often delivered in competition, for example, home care, or waste disposal and are therefore not provided as an "exclusive" right.

Regarding the water sector, the EU's services schedules contain a particular reservation. In the CETA and the draft TTIP schedule the EU reserves the right to adopt or maintain any measure "with with respect to the provision of services relating to the collection, purification and distribution of water". But as this reservation is limited to drinking water it does not cover waste from sewerage, this clause effectively undermines interconnected multi-utilities providing both water and sewerage services.

The reservation applying to drinking water contains another important loophole: it does not extend to the generalized obligation to guarantee investment protection. Thus a company domiciled in Canada or the US could claim breaches of the 'fair and equitable treatment' standard or the prohibition of 'indirect expropriation' when local councils take measures potentially limiting its profits. This option can also be exercised by European multinationals established in the North American markets.

The freedom of public utilities in the energy sector to produce and distribute energy according to public preferences by supporting renewables or remunicipalizing services might also be affected by TTIP and CETA. An analysis of the latest draft TTIP offer shows that the freedom to shape local energy systems on the municipal level could be restricted. In order to defend their policy space, the EU or the member states would need to make specific reservations protecting energy production and distribution in the schedules' Annex II, providing some limited space for current and future state measures. However, these kinds of reservations are largely missing. Among the member states, only Belgium, Portugal, and Slovakia, for instance, explicitly reserve their rights to adopt measures with respect to the "production of electricity".

Equally scarce are reservations concerning the local energy distribution networks, many of which are currently remunicipalized, particularly in Germany. Only very few of the 28 EU member states (which include Belgium, Bulgaria, Hungary and Slovakia) reserve their rights to adopt measures with respect to "energy Distribution" or "services incidental to energy distribution" in Annex II of the latest EU TTIP schedule. Moreover, all member states, including those having made some reservations, face the risk of investment disputes given the loophole in the EU's schedule of commitments allowing ISDS claims against any of the measures addressed under the reservations. These instruments could equally be used by US energy companies such as General Electric or ExxonMobil.

The document further says that in its schedule of commitments contained in CETA and the latest TTIP draft, the EU has included specific reservations for education and health services limiting the treaties' liberalization to "privately funded" services. The reservation stipulates that the EU "reserves the right to adopt or maintain any measure" with regard to education, health and social services "which receive public funding or State support in any form, and are therefore not considered to be privately funded". At first consideration, the clause might appear to save publicly funded services from specific treaty rules. Nevertheless, there are some problems with this reservation that potentially limits its scope. These problems are mainly related to the fact that many public institutions receive mixed funding from public and private sources or generate some revenue from commercial activities.

1. The reservation does not determine the actual proportion of public financing which might be required to qualify as a public service outside the scope of the trade agreement. Thus, services receiving only small amounts of state support might still be regarded as privately funded.
2. The cause suggests that the support relates to specific services, not the institutions providing these services. As a consequence, fee-based services offered by public institutions (eg language courses at adult education centres, master's programmes at public universities, or contributions to statutory health insurance schemes) might be considered as privately funded, regardless of the providers' legal status as public sector institutions.
3. The particular wording of the provision excluding only services "not considered to be privately funded" could be interpreted as treating private funding as the ultimate criterion for the classification of a service. A legal assessment of the reservation commissioned by British trade union UNITE suggests that "even a small proportion of private funding may suffice for the purposes of subjecting said services to the material scope of the Treaty".
4. The fourth problem is probably the most severe, because it relates to democratic decision making. Once the privately funded parts of the public sector have been committed in a trade agreement, central governments and local authorities effectively lose the ability to change the particular mix of public and private elements in their services sectors. As a consequence, regaining equal and affordable access to basic services by increasing the proportion of publicly funded services would become impossible.
5. Thus the scope of publicly funded services protected by this reservation appears to be rather limited. In addition, it has to be kept in mind that privately funded services may still continue their expansion.

As the weak EU reservations do not exclude public services, the corporate sector is increasingly eyeing the opening up of the education market via TTIP. It is disturbing to learn that the Commission is negotiating about US requests relating to the education sector whose details remain unknown to member states, and consequently also to their parliaments.

A report prepared by Germany's economic ministry about a meeting of the Council's Trade Policy Committee held in July 2014 mentions a few of the education sectors the US included in its request such as management trainings, language courses, and high school admission tests. The report says it would be "urgently necessary that the Commission gets to know the potential flexibilities of the Member States".

According to the German Ministry report, some member states (France, Austria, Poland, and Protugal) were pretty upset with the Commission's decision to submit the EU services offer to the US and criticized an inadequate consultation of the Trade Policy Committee (TPC): "COM explained that the offer had already been sent to the US, provoking huge annoyance among several MS claiming that the participation rights of the TPC had been restricted."

While the concrete commitments are still under negotiation, there are already several US education companies on the European market that would potentially profit from TTIP rules covering market access, national treatment, and investment protection. Allowing further US expansion into the European education system is particularly risky as US private education firms are known for aggressively fighting against regulations potentially limiting their profits.

The document says that Bertelsmann Foundation, which holds 77.6 percent of the share of the Bertelsmann group, is actively promoting TTIP by conducting surveys, commissioning reports and organizing numerous events, including a "TTIP Roadshow" demonstrating the alleged benefits of the agreement. According to the Foundation's Executive Director, Annette Heuser, one of the key areas "that should be included in TTIP negotiations is the digital economy and e-commerce". The foundation's executive advocates for the inclusion of precisely those areas where the Bertelsmann group is invested. Unsurprisingly, Heuser asserts that "TTIP is of limited value if it fails to address the 'new economy'."

The document further says that TTIP and CETA will allow investors domiciled in North America to exploit liberalization already undertaken in Europe's public health sectors to force through further market openings and to lock in past privatizations. The UK's National Health Service (NHS) is an important case in point having suffered from market-based reforms beginning in the 1980s, such a outsourcing of support services (catering, cleaning, facilities management) and the creation of an internal market where local NHS agencies purchase clinical services not only from NHS hospitals but increasingly from private providers as well. Through the UK's Private Finance Initiative (PFI) - a particular form of public-private partnerships - consortia of private companies raised money on the financial markets to construct and operate hospitals, subsequently rented back to the NHS under often over-priced lease contracts.

The latest and most radical move has been the Health and Social Care Act (HSCA) passed in 2012 stipulating that all NHS services have to be commissioned by competitive tenders, while any "qualified providers", including private companies, are entitled to bid. Many of the private companies profiting from NHS contracts maintain investment links with the US. The world's largest health care provider, Hospital Corporation of America (HCA), for instance, is expanding in UK. Care UK running many centres and residential care homes, is largely owned by private equity firm Bridgepoint, the majority of whose investors are from the US. International private equity firm Apax Partners with offices in London and New York is a shareholder in the largest private hospital chain in the UK, General Healthcare Group (GHG).

So far the market-based reforms introduced in the NHS have proved to be either negative or ineffective for the quality of care. Outsourcing of clinical services produce poor value for money as private treatment centres cherry-picked those patients with better health while referring the more complicated and expensive cases back to the NHS. Financing hospital construction through the Private Finance Initiative (PFI) left many local NHS organizations burdened with debt whereas investors generated huge returns. In a 2011, report, the UK's House of Commons Treasury Committee analyzed the reasons: "Private finance has always been more expensive than public borrowing. The difference in finance costs means that PFI projects are significantly more expensive to fund over the life of a project."

Finally the market-based reforms themselves produced huge costs: subsidizing private provider to create competition where it did not exist; creation of new institutions governing the NHS market; negotiating and monitoring contracts; managing invoicing and billing; and resolving disputes when for-profit contractors failed. The NHS's additional costs for servicing the market have been estimated at more than 4.5 billion pound per year - "enough to pay for 10 specialist hospitals" or for covering the annual costs for some 175,000 extra nurses.

With TTIP and CETA learning from past failures and reserving even a few of the NHS privatizations might become impossible. Backtracking from the now generalized tendering requirements could run counter to the commitments under the respective government procurement chapters of the trade agreements.

While referring to 'Audio-visual services' the document says that much to the annoyance of the US film industry and the European Commission, the TTIP negotiating mandate that the European Council gave to the Commission in June 2013 excluded audio-visual services. Referring to the planned chapter on trade services and establishment, the mandate says: "Audio-visual services will not be covered by the chapter". However, at the hearing of the US congress in July 2013, the United States Trade Representative, Michael Froman, stressed that the US would not back down. The European Commission, too, made unmistakably clear that it would not give up the fight. In a memo on the endorsement of the mandate it declared: "There is not curve-out on audiovisual services. As the EU legislation in this area still has to be developed, it has been agreed that audio-visual services are presently not part of the mandate, but that the Commission has the possibility to come back to the Council with additional negotiating directives at a later stage". Meanwhile, negotiators are debating the actual scope of the exemption as there is no consensus on what constitutes audiovisual services.

In an internal report to the Council's Trade Policy Committee on the fourth TTIP negotiation round, the Commission admits that the scope of the audio-visual exemption is largely unclear: "EU explained that it could not provide an abstract definition of what is covered by the concept of 'audio-visual services' and that a case-by-case assessment is required." But such a case-by-case approach could enable the Commission to grant concession to the US specific audiovisual sectors despite the exemption. This approach may also please the US negotiators whose main interest is "delineate the borders of the EU exclusions", according to the report.

Internal Commission documents summarizing meetings with industry prove that DG Trade has indeed tried to limit the audio-visual exemption as far as possible. The tendency is to only exempt a limited set of services engaged in audiovisual content production, leaving any aspects relating to the transmission, distribution, or broadcast of these contents to be liberalized. However, the Commission approach poses a severe risk to cultural diversity in Europe. Liberalizing transmission of audiovisual content to the public might lead to questioning the quotas in EU member states reserving specific percentages of TV and cinema screenings to movies produced in Europe. Opening transmission and broadcasting would undoubtedly be an important concession to the US.

As far as 'the financialization of social services' is concerned, it points out that financial investors engaged in public services may benefit from particular TTIP and CETA provisions fostering market access for new financial services and protecting investments. The CETA text and TTIP draft have many provisions also affecting financial investments in public services. The latest TTIP draft, for instance, explicitly mentions "capital participation in a juridical person" as an activity covered by the treaty, alongside many financial services including "lending of all types" and "financial leasing". Furthermore, the TTIP draft requires a party to approve any new financial service: "Each party shall permit a financial service supplier of the other party to provide any new financial service." These provisions could be used by many financial investors to defend their interests against burdensome regulations threatening their profits, for instance, in the health and social services sector. With their home market saturated, US real estate investment trusts IREITs) are increasingly turning to Europe, particularly France, Germany, and the UK.

Should TTIP and CETA come into force, adopting new regulations protecting the long-term care sector against asset-stripping strategies of financial investors could prove particularly difficult when governments continue their lax scheduling approach. Under CETA and the recent TTIP draft eleven EU Member States (Belgium, Cyprus, Denmark, France, Germany, Greece, Ireland, Italy, Portugal, Spain, the UK) introduced a reservation in their schedule of commitments de facto liberalizing long-term care such as residential homes for the elderly. According to this clause, these countries reserve their right to adopt or maintain any measure regarding "privately funded social services other than services relating to Convalescent and Rest Houses and Old People's Homes." However, completely liberalizing old people's homes is at odds with the recently published joint report of the European Commission and the Social Protection Committee recommending the integration of long-term care in national social protection systems.

For defending a corporate privilege, the European Commission is set to fulfill probably one of the most important demands of the corporate sector by including far-reaching investment protections in its transatlantic trade agreements. With the entry into force of the Lisbon Treaty in December 2009, foreign direct investment became an EU competency allowing the commission to integrate investment protection including Investor-State Dispute Settlement (ISDS) mechanisms in its FTAs. Already a common feature of bilateral investment treaties (BITs), ISDS is increasingly being integrated into trade agreements as well. However, to date, neither the EU nor any of the Western European Member States has a BIT with Canada or the United States. Only several Eastern European countries signed BITs with Canada (7 EU Member States) and the United States (9 EU Members States).

Despite growing public opposition to the private investment arbitration system, CETA already contains a comprehensive investment protection chapter including ISDS. To safeguard a similar chapter foreseen in TTIP, the Commission recently tabled some limited reform proposals unsuitable to address the fundamental shortcomings of these procedures, above all the unjustifiable privilege granted exclusively to foreign investors to bypass national courts by taking recourse to international investment tribunals.

Should TTIP come into force, thousands of US corporations' European subsidiaries could provide the basis for ISDS claims against EU member states. ISDS has evolved into a lucrative business dominated by a handful of international law firms and a small club of elite lawyers presiding over a large part of the cases.

The document further says that the vague investment rules contained in the treaties allow arbitrators expansive interpretations of individual clauses. The main clauses regularly invoked by claimants are the standard of "fair and equitable treatment" and the duty to compensate "indirect expropriations", both of which feature in CETA and are also very likely to appear in TTIP. Investor attacks on states thus far have relied most often upon the fair and equitable treatment (FET) clause. Regulatory changes, such as new laws or taxes diminishing private profits, may be seen as breaches of an investor's "legitimate expectations" justifying multi-billion euro payouts in compensation. Moreover, some arbitration tribunals have interpreted the FET standard as a state obligation to maintain a "stable and predictable business environment".

The second important standard, "protection against indirect expropriation", refer to state measures depriving investors of the economic value of their assets by limiting the ability to profit from their property. Unlike direct expropriations, this standard does not involve an outright seizure of property as, for example, in the case of nationalizations of land or a factory. Thus, "indirect expropriation" lends itself to an extremely broad range of interpretation. For example, tribunals have already denounced many public interest regulations as measures "tantamount" or "equivalent" to expropriation - and ordered states to pay multi-millions of euros in compensation.

Due to the risk of paying hefty compensations even the threat of investment arbitration may deter governments from taking necessary measures, a phenomenon called "regulatory chill". In some cases government succeeded in avoiding a costly payout by entering into a settlement agreement with the investors. However, the terms of a settlement may also oblige them to modify or abandon planned regulations.

Policies regulating public services have been a frequent target of ISDS claims launched by foreign investors using either existing BITs or the ISDS mechanism of the Energy Chapter Treaty, a plurilateral agreement on energy cooperation signed by the EU and all its member states. The experiences so far high light the imminent threats for public services emanating from investment protection and ISDS (see box 11).

CONCLUSION: Democracy and Social Justice, Not Trade Deals Threatening Public Services

The document concludes saying that TTIP and CETA pose an enormous threat to public services in the EU, as evidenced by far reaching requests made by corporate lobby groups and the fact that large numbers of their demands have found their way into trade negotiations.

The losers will be all those who depend on quality services such as healthcare, education, water, energy as well as social, cultural and communication services. While private profits grow, workers face the risk of deteriorating labour standards and the public of impaired access to essential services. People already marginalized may end up unserved if ever more public services will be converted to for-profit enterprises.

The analysis also shows that many official assurances that public services will remain unaffected by the transatlantic trade agreements are simply wrong. The different reservations introduced into the agreements, both in the rules part and the schedules of commitments, are inadequate to effectively protect the public sector and democratic decision making over how to organize it. By committing any privately funded services to be covered by these trade treaties, governments effectively also include those welfare and public sectors currently run with a public-private mix.

It further says that restricting our policy space, TTIP and CETA undermine many efforts aimed at fostering social cohesion, job creation, the redistribution of wealth, the protection of health, and the preservation of a sound natural environment. The only measure to effectively protect public services from the great trade attack would be a full and unequivocal exclusion of all public services from any EU trade agreements and the ongoing trade negotiations. A curve-out of public services is completely in line with the EU's Lisbon treaty, whose Protocol on Services of General Interest emphasizes the "essential role and the wide discretion of national, regional and local authorities" in organizing and providing public services. In this respect, it is encouraging to see that the European Parliament's TTIP resolution voted in July 2015 asks for the exclusion of public services from the agreement's scope of application.

Today we can see that governments and local authorities who have learned their lessons from failed experiments are starting to reverse liberalizations and privatizations decided in the past. Re-municipalizations are taking place in the water, energy and transport sectors, in-sourcing happens in catering, cleaning, and waste services. Some governments are even trying to reverse fatal privatizations of pensions systems. Trade agreements should not get in the way of these democratic processes. A full and unequivocal exclusion of all public services would preserve our ability to change course if needed and reorganize our essential services according to the needs of society.

Finally it says that a potential carve-out of public services alone would certainly not be sufficient to undo the manifold threats posed by CETA and TTIP. These agreements are ushering in many more provisions endangering democracy and the well-being of citizens. An ISDS mechanism, including a reformed one, granting foreign investors the exclusive privilege to bypass national courts remains unacceptable as it undermines core principles of the rule of law such as equal access to justice for all. Equally undemocratic would be the implementation of regulatory cooperation bodies enabling bureaucrats together with business stakeholders to devise regulations and laws, even before parliaments could have a say. As long as these trade agreements do not unambiguously protect the ability to regulate in the public interest, they have to be rejected. TTIP and CETA, as they are shaped now, do not satisfy the real needs of our societies still struggling with the ongoing financial crisis. Not unfettered liberalization, but bold measures fostering democracy, social justice, and wellbeing for all should be on the agenda now.

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